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Minister of Industry, Trade and Technology

It gives me great pleasure to issue this report on *The State of Small Business* in Ontario. It is the first edition of what will be an annual publication that looks at the vital importance of small business in our economy and the role of the government in assisting this sector.

Small companies now provide the vast bulk of new job opportunities for Canadians, a fact that has been recognized by this government.

In recent months, we have established a Committee of Parliamentary Assistants to investigate ways of stimulating the creation of more new firms.

That committee has already produced results through the New Ventures loan guarantee program. New Ventures is expected to open up over \$100 million a year in financing through private lenders.

This will make a significant contribution toward the formation of more than 100,000 new companies expected in the next 12 months. These new firms, in turn, promise to create many more jobs for Ontarians.

This government will continue to seek out new ways of stimulating the entrepreneurial abilities of the people of the province so that we may build a strong base for our future prosperity.

A handwritten signature in cursive script, reading "Hugh P. O'Neil".

Hugh P. O'Neil
Minister of Industry,
Trade and Technology

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Report of the Committee of Parliamentary Assistants for Small Business





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Committee of Parliamentary Assistants for Small Business

December 1, 1986

The Honourable Hugh P. O'Neil
Minister
Ministry of Industry, Trade
and Technology
8th Floor, Hearst Block
Queen's Park
Toronto, Ontario

Dear Mr. Minister:

I have the honour and privilege of presenting to you the first annual report on *The State of Small Business*. This document contains important findings on the outstanding contributions of small business owners, their firms and employees to the economic prosperity of the province.

The Committee of Parliamentary Assistants for Small Business is issuing this report to the Legislature to highlight the government's achievements in support of small business. We are especially proud of the New Ventures program, which is making available guaranteed loans to help thousands of new businesses succeed.

In addition to showing the exciting record of small business expansion and job creation, *The State of Small Business* sets forth concerns of the small business community. If we are to continue enjoying the benefits of dynamic, innovative, growing entrepreneurship, the government and all members of the Legislature must give due priority to enhancing Ontario's business climate. With this goal in mind, it is a particular strength of the committee that all members are involved in ministries of the government that directly affect the interests of small business owners.

On behalf of the committee, I thank you for the support and encouragement you and officials of your ministry have given us over the past year.

Yours sincerely,

A handwritten signature in cursive script, appearing to read "Rick Ferraro".

Rick Ferraro, M.P.P.
Chairman
Committee of Parliamentary Assistants
for Small Business

Report of the Committee of Parliamentary Assistants for Small Business

This is our first report to the Ontario Legislature on the state of small business in the province. It details the performance, concerns and priorities of the most dynamic segment of our economy — Ontario's 304,000 small business owners.

The Committee of Parliamentary Assistants for Small Business, appointed by the Premier and the Minister of Industry, Trade and Technology in January, 1986, is issuing this public statement and annual report on small business in order to celebrate the achievements of Ontario's entrepreneurs and raise the priority of small business concerns on the legislative agenda.

The committee also wishes to report on its activities and achievements toward fulfilling its mandate, announced in April, 1986, by the Minister of Industry, Trade and Technology. That mandate is:

1. to demonstrate to the business community that the Ontario government has a positive, coordinated approach to small business owners;
2. to consider existing programs for small business and ensure that they are effective, accessible and designed to provide maximum benefit;
3. to develop a process for reviewing existing regulation and screening new legislation and rules to make them as responsive as possible to the realities of doing business;
4. to advise the government on new ideas and initiatives in support of small business.

Shortly after the appointment of the committee, the minister announced that its chairman, Rick Ferraro, MPP (Wellington South), would be appointed to the position of Small Business Advocate. This appointment underlines the importance of advocacy in the mandate of the committee. It responds to the insistence of business owners that the government create a focus for the views of small business to be represented effectively within the government. Mr. Ferraro and members of the committee have been identified as the point of access for groups

that wish to engage the government in dialogue on small business issues.

Members of the committee are also working within their respective ministries to improve the regulatory climate for small business. This is a main strength of the committee as its members represent key ministries that affect the environment for entrepreneurship in Ontario.

The committee has a special responsibility to promote small business to the public. This report documents the contribution of Ontario's 304,000 business owners to job creation, innovation and economic opportunity. It shows how they are helping to provide a rising standard of living and directly affecting the livelihoods of four million Ontarians. Increased awareness of the importance of small business to our prosperity will help build support for actions that are favourable to entrepreneurship. This is a key strategy for developing and maintaining a favourable business climate in the province.

Listening to Small Business Owners

The first step the committee took as soon as its existence was announced was to listen to small business owners. Starting in April, 1986, the committee began to meet with business groups. These included the Canadian Federation of Independent Business, the Canadian Organization of Small Business, the Ontario Chamber of Commerce, the Canadian Manufacturers' Association, the Canadian Association of Women Executives and Entrepreneurs, the Canadian Association of Family Enterprise, the Retail Council of Canada, Tourism Ontario, the Ontario Trucking Association, the Board of Trade of Metropolitan Toronto, the Council of Ontario Contractors Association, the Insurance Brokers Association of Ontario, the Ontario Nursing Home Association and others.

Listening to business was essential in order to understand the real concerns of the small business community. It was also important in order to set priorities for what the government should do for small business jointly with those affected. The committee also understood that consultation was part of its mandate to provide a point of contact and recognize small business owners as a highly legitimate interest group.

Those meetings communicated vital messages to members of the committee. Business groups voiced their concerns about the relationship between business and the government in the province. There were searching questions about how the government's legislative agenda would impact the cost and practices of doing business in Ontario. In particular, business owners spoke about impending legisla-

tion in areas of labour relations, employment standards and pay equity. They warned the government that the burden of taxation — and in particular payroll taxes — was a powerful disincentive to investment and job creation. They pointed out serious problems of getting capital, especially equity financing, to start new firms and make established companies grow.

In addition to the messages of concern, there was a heartening acceptance of the committee's role and mandate. Business groups confirmed that the government had acted wisely in setting up a unified point of access. They were willing to believe the committee could be useful and deserved their cooperation.

The committee has found that it can serve as a channel to the government for the small business community and help boost the voice of the small business owner in the hurly-burly of interest group competition. The business owner as an individual can rarely take the time to participate in the process of government and yet the government inevitably looms large as a factor in the profitability and even survival of many small companies. While business associations play a crucial role in voicing the needs of their constituents, there are many instances when a voice inside the government can complement the organized business community. For one thing, new policy and legislation are often conceived and developed over a period of time prior to public debate.

Committee members also perceived that they could help reconcile the broad public interest embodied in the government's policy directions and the particular needs of the small business community. They discovered opportunities to advise the government on how and when new legislation would impact the business owner. In this way, the government could develop more sensitivity to the needs of small business and its capacity to change and adapt to new conditions.

Achievements for Small Business

In its first year, the government has received wide approval for the way it has moved forward to fulfill its legislative and policy agenda. In addition to achievements in fields such as health care, the environment, labour and the status of women, the government has put in place valuable initiatives for economic growth. The Committee of Parliamentary Assistants for Small Business has played a part in some of the most important measures in support of Ontario's entrepreneurs.

The first major achievement of the committee was the New Ventures program. The committee understood immediately the critical problem of raising more investment capital to start new companies and

began early last winter to map out a strategic response. The result, New Ventures guaranteed loans, available from private lenders at more than 1,500 local branches across the province, is a revolutionary development in government assistance to business. Armed with the provincial guarantee, the business owner who has a good idea, solid knowledge of the market and a well formulated business plan can obtain start-up financing to match his or her own stake in the new company up to \$15,000. A key element of New Ventures is its direct delivery by financial institutions. The committee hopes that New Ventures will encourage more financial institutions to provide commercial credit to small businesses.

The committee developed this proposal in close consultation with the business community. The Treasurer of Ontario, the Honourable Robert Nixon, made New Ventures a feature of the 1986 Ontario Budget. New Ventures will, in its first full year of operation, guarantee loans to 7,000 new businesses and stimulate more than \$100 million of new small business lending in the province. The employment dividends to Ontario will be large, creating jobs for more than 20,000 people.

The government has also teamed up in support of small business with the Ontario Chamber of Commerce. The government and the Chamber are collaborating to establish the Computerized Ontario Investment Network (COIN). The network will match investors and business owners across the province, improving the placement of investment capital. The Chamber is responsible for developing COIN, and the government is lending support for promoting the program and providing advice and counsel services to participants.

On May 26, 1986, the committee and ministry officials briefed the government caucus on small business in Ontario. The committee mapped out its priorities and the exciting opportunities for the government to move forward in the small business field. Members of the government caucus were enthusiastic in support of the committee's approach and confident that support of small business would create jobs and strengthen Ontario's economy.

The committee has linked up with like-minded groups in other provinces and at the federal level as well. Mr. Ferraro met with the chairman of Manitoba's legislative committee for small business and initiated an exchange of information. Similarly, ideas from Quebec's task force on regulatory reform have been embodied in the committee's work program. The committee has supported federal initiatives to promote community-based investment such as changes in Registered Retirement Savings Plan rules to permit investment in small business.

Ontario is working with the federal Small Business Secretariat to promote the opportunities to raise equity capital through such new tax provisions.

As members of the legislature, we have considered how MPPs can assist constituents who may want to start a business or get management assistance through the government's advice and counsel programs. At the committee's suggestion, the Ministry of Industry, Trade and Technology has provided a selection of small business literature to all members of the legislature in a convenient display rack for constituency offices. These racks contain vital information on starting a business, financing sources and educational seminars and publications available to business owners and new entrepreneurs.

The government's small business initiatives, especially New Ventures, have stimulated a strong response from the public. The toll-free Small Business Hotline now averages 340 calls a day. The hotline provides a central access point for information on government programs, rules and regulations. Operators answer entrepreneurs' basic questions and refer callers to the appropriate agency for detailed information.

Among the leading issues on the government's agenda in the past year were several that have strong implications for the small business community. The committee has been quick to express its views on them. Committee members briefed the Minister of Consumer and Commercial Relations on the importance to small business of the legislation to permit independent grocery stores to sell beer and wine. The committee has monitored the formulation of legislation to implement the government's promise of equal pay for work of equal value in the private sector. Several business groups have approached the committee on the question of hours of work and overtime. The Minister of Industry, Trade and Technology has asked the Committee of Parliamentary Assistants to consider the federal government's study of regulation and paper burden as it affects Ontario small business and report on a comprehensive strategy for reform.

As members of the legislature, committee members have worked on other issues important to small business owners. For example, the legislative committee on economic policy has studied the question of free trade with the United States. Another member of the committee, Steven Offer, MPP (Mississauga), has been appointed to chair the government's review of liquor regulations. In all these endeavors, members are consulting with their colleagues and taking the impact on small business owners into account.

In order to make wise decisions and advise the government competently on issues affecting small business, the committee has adopted a research program to provide the best available information on small business and its economic environment. Initial results of these efforts are contained in this report on small business. Future reports will convey more extensive information on the performance of small business, its leading concerns and the prospects for growth.

In all of these efforts, the Committee of Parliamentary Assistants has received strong support from officials of the Ministry of Industry, Trade and Technology. The result has been very effective work on behalf of the small business owners of the province.

Highlights of the First Annual Report on Small Business

While the report on small business deserves detailed study, members of the committee want to highlight key findings for members of the legislature and the public. These findings establish a new frame of reference for understanding small business and the Ontario economy.

1. Small business is a mass phenomenon. There are 304,000 small business owners in Ontario and most of them — over 90 per cent — have fewer than 20 employees.
2. Small business continues to be the most dynamic source of job creation. Eighty-two percent of all net new jobs in Ontario came from small business and the majority of those from the formation of new companies. The province's small service sector businesses accounted for over two-thirds of the net job gain.
3. Ontario is experiencing a rising wave of new business formation. In the past year, 99,000 new companies were formed in the province, and the annual rate is constantly rising.
4. The dynamic performance of start-up companies is not matched by growth to medium size. Policymakers must turn their attention to how more companies can make the transition from small to medium size and reach a scale of national and international competitiveness.
5. The participation of women and young people as small business owners is increasing significantly. Nearly a quarter of Ontario businesses are now owned by women. Young people under the age of 30 now account for over 40 percent of business starts.
6. Ontario has a very positive business climate, to all indications the most favourable in Canada.

The Small Business Challenge

After nearly a year of listening to small business owners, the committee is sensitive to the needs of small businesses. Above all, small business owners want and need a positive business climate. Rather than seeking subsidies or special privileges, business owners want an environment that lets them achieve their full potential. That means an environment in which the drag of excessive regulation is kept to a minimum. It means running a lean and efficient government so that the entrepreneur carries the lowest possible tax burden. It means public recognition of enterprise and expressions of esteem for the social value of the entrepreneur. As George Gilder wrote in *The Spirit of Enterprise*, "Society is always in debt to the entrepreneurs who sustain it and rarely consume by themselves more than the smallest share of what they give society."¹

More specifically, a positive business climate consists of conditions favourable to investment. That requires that investors have reasonable expectations of profit commensurate with risk. It requires a degree of stability in taxation and regulation so that business owners and investors can act with reasonable certainty about the rules of the game.

New policies and legislation should take into account the special needs of the small business owner, especially businesses at the vulnerable stage of start-up when money is scarce and time to prepare for business ownership is at a premium. The government must also constantly bear in mind the severely limited resources of the small firm to comply with laws and regulations. Wherever possible, the demands a government places on the small firm should be simpler, cheaper and clearer than for business in general. All of the bugs should be worked out of legislation before it is applied to the small company.

The committee calls to the attention of the legislature the challenges of the year ahead in shaping a business climate friendly to small firms. The first challenge is to commit ourselves to making progress with sensitivity to the trade-offs between goals in labour and social legislation, the environment, health care and so on and the particular costs and burdens of compliance that fall on the small business owner. Secondly, the government should reform the process of legislation and regulation with procedures for early notice, regulatory flexibility and small business impact studies. Thirdly, in concert with the federal government, Ontario should reinforce initiatives already in place for community based financing of small business. Finally, the government should make small business a central element of regional development strategy.

We are convinced that small business owners are making an enormous contribution to Ontario's development and prosperity. Their values, talents and energies are helping us move toward the province's full potential. Most importantly, entrepreneurs and small business owners are a precious resource found in every community and region. To fully liberate and benefit from that resource, the government will be called on to act on the challenges set out in this report. We are hopeful that the government and members of the legislature will continue to respond with faith in Ontario's small business community.

¹George Gilder, *The Spirit of Enterprise*, Simon and Schuster, 1984, p. 17.

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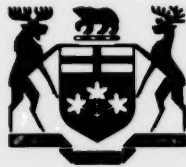




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Acknowledgement

The Government of Ontario would like to recognize the sources underlying the quality and content of this first *Annual Report on Small Business in Ontario*.

The project was designed and prepared by Lance H. K. Secretan, a recognized expert on small business and entrepreneurship. Original research and editing was undertaken by Alan Harman. The report gained significantly from the thoughtful advice and technical assistance offered by Rena Blatt, Small Business Advocate, Ontario Ministry of Industry, Trade and Technology.

A great many contributors, advisors and sources have helped shape the final content of this study, including:

Association of Canadian Franchisors
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Candida Brush
Canadian Bankers' Association
Canadian Federation of Independent Business
Clarkson Gordon
J.A. (Al) Cotton, Toronto Dominion Bank
Department of Regional Industrial Expansion
Federal Business Development Bank
Robert D. Hisrich
Russell M. Knight
Greg Leach
Isiah A. Litvak
Christopher J. Maule
Ministry of Industry, Trade and Technology
Naisbitt Group
Mari A. Peterson
Rein Peterson
Small Business Secretariat
Statistics Canada
Lois Stevenson
Andrew Szonyi
U.S. Small Business Administration
Jerry White, Laventhol and Horwath

1 Executive Summary

The Canadian small business sector is often defined as those firms with up to \$2 million in annual sales or employing fewer than 50 employees. By this definition, some 750,000 small businesses account for 96 percent of all Canadian firms, and, although the majority of them employ fewer than 20 people, they account for 26 percent of all employment. Between 1978 and 1984, they accounted for 96 percent of the net new job creation across the country.

Employment and Job Creation

Between 1978 and 1982, firms with fewer than five employees accounted for 96.5 percent of all jobs created in the Canadian private sector. During the same period, companies employing fewer than 20 employees accounted for 90 percent of net new job creation. These ultra-small firms are the source of most new business start-ups. Start-up companies created 40 percent of all new job opportunities in Canada from 1978 to 1982, demonstrating their crucial actual and potential impact on wealth creation and the reduction of current unemployment levels.

In 1982, Ontario enjoyed 38.9 percent of Canada's employment. In that year, Ontario's private sector employment growth rates did not equal the national average. Ontario's manufacturing sector is proportionately larger than those of other provinces, making it more susceptible to economic vicissitudes, and the relative size and previous vigor of Ontario's economy made the continuance of sizeable year-on-year employment gains difficult to maintain.

By 1984, in a burst of economic energy, Ontario was well into the post-recession expansion. From 1978 to 1984, 393,000 new jobs were created in the province, almost half of the increase in employment across Canada. Small firms with fewer than 20 employees accounted for 74 percent of the new jobs for Ontarians in that six year period. Ontario's definition of a small business is one employing fewer than 100 workers.

In 1985, Ontarians formed 99,000 new businesses, of which 33,800 were firms hiring additional employees beyond the owner. They created over 180,000 new job opportunities and generated \$500 million in new investment.

Sectoral Distribution of Small Business

Of the 304,000 small businesses in Ontario, 92 percent of them are in the service sector, seven percent in manufacturing and one percent in natural resources. They account for 98 percent of all companies and 50 percent of private sector employment in Ontario.

Ontario accounts for 34 percent of all manufacturing establishments in Canada, over 60 percent of Canada's manufacturing sales and 52 percent of Canadian employment in manufacturing.

In the tertiary sector of the Canadian economy (those companies that are not members of the manufacturing or resource industries), the vast majority of firms are small businesses. They are especially dominant in the service, construction and finance sectors. It is because of these demographics that small businesses have played such a pivotal role in fuelling Canada's recent economic performance.

Small businesses that provide services to other businesses are one of the fastest growth sectors of the economy. In the last 10 years, the number of staff employed in these firms has grown by 67.8 percent (297,000 to 498,000), more than three times the national average of 19.4 percent. This sector includes, among others, accounting, advertising, architecture, computer services, employment agencies, engineering and scientific services, law, management and business counselling, security and investigation, and miscellaneous services to business management. The driving force behind this phenomenon is the "demassing" of major corporations and the tendency to "functional externalization." This term refers to the growing practice of larger companies to subcontract their service functions as well as many support activities to outside specialists.

Youth

Small businesses employ disproportionate numbers of Canada's youth. Although 52 percent of employed Canadians work in medium and large companies, these firms only provide employment to 30 percent of those under 25 years of age. Small businesses, on the other hand, account for only 48 percent of total employment but employ 70 percent of young Canadians. Young Canadians are also turning to entrepreneurship and new business start-ups as a viable alternative to traditional employment and, in some cases, economic inactivity.

Births, Deaths, Contractions and Expansions of Small Businesses

New corporations approximate 15 percent of the number of corporations on record for an immediately previous period. This growth rate is exceptionally high when compared with, for example, the United States and Europe. Two new corporations are started for each one that ceases business or is discontinued, yielding a net increase of 7.5 percent in the number of firms.

During 1985, some five percent more businesses were formed than were closed. Business deaths were at a record low of 5.8 percent across Canada compared to 7.4 percent in 1984. Ontario's performance led the nation. For firms employing fewer than five employees, the 65.4 percent growth in employment between 1978 and 1982 was more a result of births and deaths than expansion and contraction of firms. Of the 400,167 net jobs created in 1982 by firms with fewer than five employees, 402,291 jobs were the result of new businesses and 264,549 jobs were created by the expansion of existing firms. Death or contraction of firms caused the loss of 180,491 and 86,182 jobs respectively. The closure of firms with more than five employees caused the loss of more jobs than were created by new start-ups, but the expansion of existing firms caused a net increase in employment.

Demographics of Small Businesses and Their Owners

In Ontario, 77 percent of the new business owners are males, 23 percent are females; 48.4 percent of the owners are between 30 and 50 years old, only 6.1 percent are over 50 and the rest, 45.5 percent, are under 30.

Forty percent of male and 43 percent of female new business owners in Ontario have high school education, and 32 percent of women and 28 percent of men starting new businesses have completed a university level education. Also, the parents of female small business owners — particularly their fathers — are more highly educated than the general populace. The majority of female small business owners come from middle class families and have university degrees.

A recent Canadian study found that nearly 60 percent of inventor/entrepreneurs and founders of technologically based companies had university degrees and that most of them had assumed managerial roles in large corporations after graduating, the majority starting their businesses between the ages of 35 and 40. They tended to establish new businesses in fields in which they had previous experience.

The Franchising Phenomenon

Franchising is leading the expansion of the small business sector. Estimated total sales of Canadian franchised units in 1985 was nearly \$50 billion — over one third of total Canadian retail sales. Between 1981 and 1984, franchises averaged annual sales growth of 15 percent compared to 7.7 percent for the retail sales sector as a whole and total GNP growth of 7.4 percent. Fifty-three percent of all franchise units and 47 percent of franchised sales are located in Ontario. Quebec ranks next with 13 percent and 27 percent respectively. Sixty-one percent of all franchisors' head offices are located in Ontario, with B.C. claiming the next largest proportion of head offices with 13 percent.

A sample of franchisors accounting for 10 percent of Canadian franchise sales expect revenues to increase by a further 50 percent between 1985 and 1989 compared to a projected 35 percent increase for the total retail sector and a 28 percent growth for total GNP during the same period.

Women Small Business Owners

Female owners of small businesses tend to avoid those sectors that have traditionally been male-dominated, such as manufacturing, choosing instead the service sector. The service sector is favored by 66.1 percent of female owners of new businesses; 29.8 percent start retail firms and 4.1 percent start manufacturing businesses. Women are less likely to start service businesses and more likely to start retail businesses than are men.

Profitability of Small Businesses

While the smaller firms create the majority of new jobs, their financial results are not commensurate. Almost 60 percent of small firms fall outside "normal" rates of return on assets (0 to 16 percent), while only 23 percent of large firms do so.

A contributing factor to the poor profit performance of the small business sector has been the rising level and cost of debt. The interest burden (calculated as interest/profit before tax) has grown for companies of all sizes. From 1979 to 1984, the interest burden for large companies grew from 20 percent to 42 percent. However, among small and medium sized firms, the interest burden grew from 35 percent to 62 percent during the same period. The interest burden of small firms has been some 50 percent higher than the large company experience, but their profits have only been one-fifth and their profit margins one-third of those of the large firms.

Financing Small Businesses

The structure of small firms' balance sheets is far more likely to be characterized by short term liabilities than is that of larger companies. Smallest firms have a ratio of 55 percent liabilities to 45 percent equity while large firms have a ratio of 41 percent liabilities to 59 percent equity. These balances between liabilities and equity are aggravated by the relationship between short and long term debt. Small firms carry 41 percent short term and 14 percent long term debt whereas larger corporations have only 19 percent of their financing in short term debt.

Of the estimated 750,000 small businesses in Canada, 86.2 percent use a chartered bank as their primary source of financing and 78.1 percent bank with one of the "big five." At the end of the third quarter of 1985, the chartered banks reported \$15.9 billion in loans outstanding to small businesses (an increase of \$2 billion or 13 percent since 1982). Government guaranteed loans made up about 10 percent of the banks' small business loan portfolio. Small business and the major banks enjoy a relationship that is very important to both parties; indeed, loans to small business represent almost 25 percent of the banks' total lending portfolio.

The average start-up funding of new firms in Ontario is \$25,000, and personal investment accounts for 68 percent of this amount for incorporated owners and 73 percent for unincorporated owners. The owners of incorporated firms invest more in their new businesses than the owners of unincorporated ones.

Nearly half of the owners of firms have no need of additional financing and two-fifths of owners need additional capital and are successful in obtaining it while just over one in 10 need additional funding and fail to obtain it.

Government Financing Programs

Ontario's Small Business Development Corporation (S.B.D.C.) program is well received by participants and is lauded by major small business organizations. An important contributing factor to its success is the efficient administration by the Ministry of Revenue. Ontario's example has encouraged the establishment of S.B.D.C. programs in several other provincial jurisdictions.

The program could be strengthened by greater access to direct equity investment if the minimum capitalization levels were reduced from \$100,000 to \$50,000 across the board.

Further benefits might be achieved by broadening the eligibility to include the service sector. The job creating power of the small service

companies is evidenced by the growth of the Canadian business service sector from 23,000 firms in 1976 to about 42,000 in 1982, and the proportion of new jobs these firms created was even greater. Service companies as a whole provided 55 new jobs for every million dollars of new sales compared to 70 in retail trade and 28 in manufacturing. This sector represents a strong opportunity for the government to encourage job creation in Ontario.

The average amount borrowed by each *Small Business Loans Act* applicant has risen from \$8,909 in 1961 to \$26,766 in 1983, and the number of borrowers has grown from 8,368 to 25,820 over the same period.

Forty percent of loans made under the aegis of the *Small Business Loans Act* are made to start-up companies compared to only 19 percent of regular high-risk company bank loans. The S.B.L.A. program results in a significant volume of term loans to small business that would not have been made if the program had not existed. As many as 50 percent of all S.B.L.A. borrowers may have obtained other financing to supplement their S.B.L.A. loans. Many loan recipients are young firms or firms with new owners, less experienced management or firms unable to offer high levels of collateral support. S.B.L.A. recipients reduce their borrowing costs by an average of between 75 and 112 basis points, enabling small businesses to obtain extended loan repayment terms.

The Ontario government has recently introduced a new program, the New Ventures program, which will guarantee loans of up to \$15,000 to small businesses from private sector lenders.

The deregulation of the securities and loan and trust industries, along with increased flexibility for pension fund operators, may provide even more financing opportunities for existing and prospective small business owners.

Developing Management Skills

Financial assistance provided by the government in Ontario is complemented by a wide variety of activities addressing the needs of small business owners for improved management skills and information.

Federal services are provided on a fee-for-service basis directly through the Federal Business Development Bank (FBDB) and its wide network of CASE (Counselling Assistance to Small Enterprise) counsellors across the province.

Provincial services focus on the new small business or the individual about to start. Stressing basic planning skills on the understanding that better preparation will lead to greater success, the Ministry of

Industry, Trade and Technology's Small Business Branch, in co-operation with 18 Domestic Field Offices across Ontario, conducts more than 200 seminars per year, distributes more than 100,000 pieces of self-help literature, directly counsels new and established small business and subsidizes the delivery of advisory services by 30 local agencies.

The increasing demand for assistance in new business planning and management skills development is reflected in the attendance of more than 5,000 individuals at provincially sponsored seminars in 1985, the increase in enquiries of MITT's Small Business Hotline to an annual rate of 85,000 and the voluntary registration of more than 16,000 individuals across Ontario as advisory service clients of the Small Business Branch.

Small Business and Government Policy

The federal government has recognized that "... small business is the engine of economic growth." Statistics Canada recently estimated that between 1974 and 1984, the small business sector accounted for 82 percent of new job creation in Ontario, large companies accounted for seven percent of job creation and medium sized firms made up 11 percent of the gain in net new jobs. Small business in Ontario accounted for approximately 48 percent of all private sector employment in 1982.

The employment effects obtained by stimulating small business industries are 70 percent greater than those that result from the stimulation of larger companies. An important policy objective of the Ontario government is the fostering of a climate that will be sympathetic to the creation of start-up opportunities for women and young persons wishing to start new businesses.

In the area of public policy action, it is estimated that in 1985, the Small Business Branch of the Ministry of Industry, Trade and Technology identified and advocated on issues that will have beneficial effects on small business in Ontario worth over \$500 million over the next four years.

Regulation and Deregulation

Twenty Ontario ministries have either a supportive or regulatory relationship with small business in the province; 27 federal departments and agencies tax, license, regulate or assist these firms; municipal government agencies and departments add a further level of government interface to the small business sector.

Nearly half of a recently surveyed sample of newly established

small businesses in Ontario ranked "government paperwork" as their number two problem (behind "profitability" [60 percent] and ahead of "finding customers" [45 percent]). Paperwork was the number one issue for all recently registered small business owners who employed staff, with 58 percent of them citing this as a major concern. While recently incorporated firms in Ontario spend 10 hours a week filling out government forms (7.5 hours in unincorporated firms), only 2.3 hours is devoted to this chore by the owners, the balance being undertaken by employees.

In 95 percent of cases, small businesses complied with economic regulations, initially absorbing the costs of compliance. Only 25 percent pass these costs on to their customers. Between one quarter and three quarters of the costs are passed on by 15 percent of the small businesses while 10 percent discontinue or avoid the line of business affected.

2 Introduction

2.1 *The Environment for Small Business*

Small business maintains its momentum even when the economy falters. Since small firms are often closer to the market and more flexible, they can respond quickly to changing market and economic conditions and, as a result, they are often the leaders in innovation.

Small businesses facilitate the structural shifts necessary in cost-push and demand-pull inflationary market conditions by adapting their cost structures and meeting changing consumer demands more rapidly than large companies. Their weak market positions and their lower levels of capitalization make these flexibilities an imperative for their survival.

The growth of small business in Canada can be seen in Tables 2.1.1 to 2.1.5.

There are 304,000 small businesses in Ontario, 92 percent of them in the service sector, seven percent in manufacturing and one percent in natural resources. These small businesses account for 98 percent of all companies and 50 percent of private sector employment in Ontario. This is shown graphically in Chart 2.1.1.

Chart 2.1.1 *Small Business in Ontario by Sector, 1985*

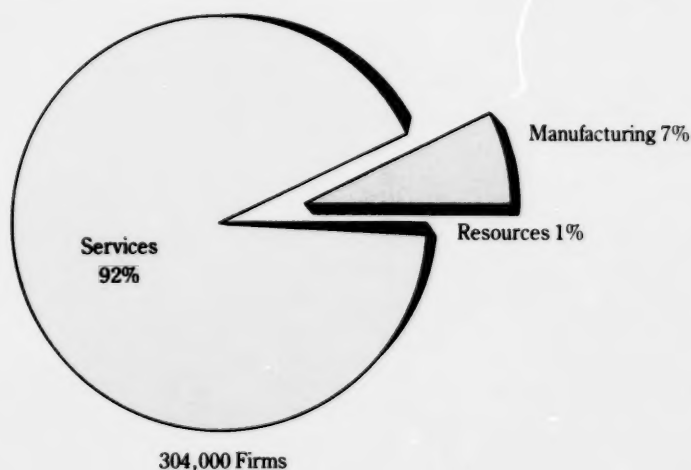


Table 2.1.1 Canadian Small Businesses by Annual Sales, 1972-1980¹

Annual Sales \$(000s)	Number of Businesses				
	1972	1974	1976	1978	1980
0-50	288,752	332,381	314,246	344,721	356,952
50-250	164,548	187,831	217,962	240,602	258,022
250-2,000	68,830	78,765	95,799	114,958	132,803
over 2,000	13,443	15,070	18,416	23,310	27,886
Total	535,573	614,047	646,423	723,591	775,663

Table 2.1.2 Canadian Small Businesses by Annual Sales, 1972-1980²

Annual Sales \$(000s)	Sales — Millions of Current Dollars				
	1972	1974	1976	1978	1980
0-50	4,258.9	6,379.4	6,489.6	7,204.2	6,978.0
50-250	14,131.9	21,455.6	25,171.8	27,994.0	30,070.9
250-2,000	32,910.0	49,995.2	60,320.0	73,605.4	86,703.4
over 2,000	142,287.4	216,344.5	283,614.2	380,729.4	458,142.9
Total	193,588.2	294,173.4	375,595.6	489,533.0	581,895.2

Table 2.1.3 *Distribution of Firms by Size of Workforce (1980)*³

	Number of Employees			
	Total	50	50-499	500 +
Canada	6,870,548	2,571,962	1,911,556	2,387,030
Ontario	2,771,948	937,596	791,960	1,042,392

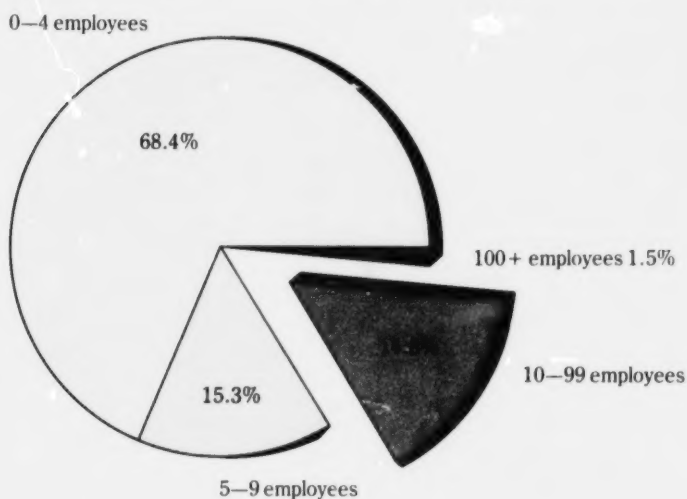
Table 2.1.4 *Small Businesses in Ontario by Firm Size, 1972-1980*⁴

Annual sales \$(000s)	Number of Businesses				
	1972	1974	1976	1978	1980
0-50	103,281	120,386	114,766	127,598	112,456
50-250	59,988	69,834	79,276	84,010	86,264
250-2,000	25,626	29,974	34,689	41,596	44,549
Total	188,895	220,194	228,731	253,204	243,269

Table 2.1.5 *Total Annual Sales of Small Businesses in Ontario by Firm Size, 1972-1980*⁵

Annual Sales \$(000s)	Sales — Millions of Dollars				
	1972	1974	1976	1978	1980
0-50	1,571.9	2,323.6	2,328.4	2,632.0	2,446.8
50-250	5,265.9	7,946.9	9,137.4	9,721.5	10,013.9
250-2,000	12,732.7	19,248.5	22,063.4	26,968.9	29,353.0
Total	19,570.5	29,519.0	33,529.2	39,322.4	41,813.7

Chart 2.1.2 Ontario Businesses by Number of Employees, 1985



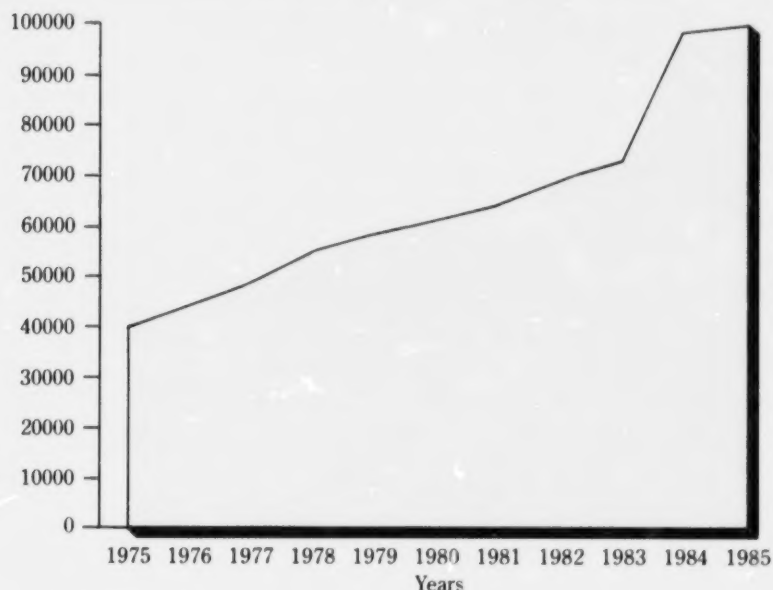
Ontario had 308,759 registered businesses in 1985

Chart 2.1.2 depicts the distribution of Ontario businesses by number of employees in 1985. The small business section, defined as those with fewer than 100 employees, accounted for over 98 percent of firms.

In 1985, Ontarians formed 99,000 new businesses of which 33,800 were firms hiring employees. They created over 180,000 new job opportunities and generated \$500 million in new investment. Chart 2.1.3 shows the formation of new companies from 1975 to 1985.

The job creation capability of small business has become a dynamic social and economic instrument, and owners and operators of small businesses are more a mass movement than a passing phenomenon. This first edition of the *Annual Report on Small Business in Ontario* seeks to build on the current momentum of public awareness and support for innovators and entrepreneurs in particular, and the small business community in general, throughout the province. It is hoped that decision makers, policy makers and researchers will find the *Annual Report on Small Business in Ontario* a useful source of current data and of the latest knowledge and thinking concerning small business performance in Ontario.

Chart 2.1.3 *New Business Formations, Ontario, 1975-1985*



Ontario's Business Climate

The year 1985 represented the fourth consecutive year of economic expansion for Canada. More jobs, stable inflation rates and lower interest rates have helped to propel the strongest consumer boom in 10 years. Lower rates for auto financing and postponed purchases from the early eighties helped the auto industry to post sales of approximately 1.1 million units. This optimism was given further support by the planned construction of major new auto manufacturing facilities in Ontario.

For similar reasons, unit housing sales enjoyed a corresponding resurgence. Consumer borrowing, household credit and residential mortgage levels were well below the record peaks reached in the late 1970s, and an increasing level of new business start-ups was fuelled by the higher personal savings available. With gross domestic output up 4.4 percent for the year and a more restrained but nevertheless healthy forecast of three percent growth for 1986, small business was presented with a positive economic environment for the following year. Table 2.1.6 compares the Ontario, Canadian and U.S. economies over

Table 2.1.6 Ontario, Canadian and U.S. Economic Performance, 1984-1986

	Ontario %		Canada %		U.S. %	
	1984	1985	1984	1985	1984	1985
Real growth	6.5	4.5	5.0	4.0	6.8	2.3
Inflation	4.4	4.1	4.4	4.1	4.3	3.6
Unemployment rate	9.1	8.2	11.3	10.7	7.5	7.2
Year-end prime rate	11.25	10.0	11.25	10.0	10.75	9.5
						9.0

Table 2.1.7 How Ontarians Perceive the Climate for Starting a New Business in Ontario^a

	Region %					
	Total	Metro Toronto	East Ont.	Central East	Central West	North Ont.
Very good	39	39	41	39	45	32
Somewhat good	44	44	46	45	44	43
Somewhat poor	8	7	6	8	7	14
Very poor	2	1	2	3	1	4
Don't know	7	9	6	6	4	7

the 1984 to 1986 period, while Table 2.1.7 expresses how Ontarians feel about the business climate.

2.2 The Definition of Small Business

Researchers, academics, policy makers and others interested in the field of small business have long been plagued by the continuing lack of a universally recognized definition of "small business." The problem of definition is further complicated when considering the eligibility of small firms wishing to access government programs. For example, under the *Small Business Loans Act*, a small business loan is only available to those companies enjoying revenues of less than \$2 million, but lower corporation tax rates are available to businesses on their first \$200,000 in annual taxable income where their cumulative deduction account balance is under \$1 million.

For the purposes of statistical analysis, in Canada and many other countries, business size is usually defined by measuring the value of assets, annual pre-tax income, annual sales or the number of employees, the latter two being the most frequently cited. The Small Business Branch of the Ontario Ministry of Industry, Trade and Technology describes small businesses as all those employing fewer than 100 workers.

Since 1977, the Small Business Secretariat, in conjunction with Statistics Canada, has used the format in Table 2.2.1 for the purposes of statistical analysis of Canadian businesses.

Table 2.2.1 Small Business Definition by Sales Volume

Firm class	Annual sales (\$ millions)
Small	less than 2
Medium	2 to 20
Large	over 20

Where employment levels are used to define business size, the difference between the more labour intensive service sector and the more capital intensive manufacturing sector is often recognized, as shown by the definition in Table 2.2.2.

Table 2.2.2 *Small Business Definition by Number of Employees*

Sector	Firm class	Number of employees
Manufacturing	Small	fewer than 100
	Medium	100-300
	Large	more than 300
Service	Small	fewer than 50
	Medium	50-200
	Large	over 200

The U.S. Small Business Administration classifies small firms as those employing fewer than 500 people.

The definition debate will be resolved elsewhere, but it is raised here to alert the reader to the varying definitions of small business used. The reader is advised to ascertain which benchmark is being used when references are made to firm size and whenever charts or tables are presented.

Another definitional issue arises out of the tendency to confuse the term "entrepreneur" with "small business owner," the two often being used interchangeably. Small business is defined above. An "entrepreneur" may be considered to be "... a person who combines risk, innovation, leadership, artistry, skill and craftsmanship into a foundation upon which to build and motivate a team. This group of human beings, sometimes previously unknown to each other, evolves into a new enterprise."⁸

Many small business owners have no pretensions to great personal achievement, innovation or creativity, all essential characteristics of the entrepreneur. They may simply prefer to work for themselves, or they may have been unsuccessful in finding an alternative, suitable career, and yet others may prefer the lifestyle offered by self-employment. Sections 5.3 and 7.2 elaborate on some of these reasons. In Section 7.2, for example, research suggests that some women start new businesses in order to escape from what they perceive to be their clerical ghettos. This may or may not result in the creation of an entrepreneurial enterprise, but entrepreneurship in itself may not be the driving force behind the firm's inception.

Joseph Schumpeter, the celebrated Austrian economist, who spent much of his academic career at Harvard and whose research helped to popularize our modern concept of the entrepreneur, pointed out that entrepreneurs differentiate themselves from others by "carrying out new combinations" of productive forces or enterprises. The entrepreneur, Schumpeter argued, functions as an agent of change in an otherwise repetitive social economy. Entrepreneurs, he surmised, did things that were often already being done in new and innovative ways by defining (1) new products or services, (2) new methods of production, (3) new markets, (4) new sources of supply or (5) new forms of organization.⁹

Thus, when we look at small business owners, we are not necessarily studying entrepreneurs (nor inventors, who fall into yet another category).

Chapter Notes

¹*Small Business Statistics*, Statistics Canada.

²*Ibid.*

³*A Study of Job Creation in Canada, 1976-1984*, Department of Regional Industrial Expansion, 1986.

⁴*Statistical Profile of Small Business in Canada, 1983*, Small Business Secretariat, Department of Regional Industrial Expansion.

⁵*Ibid.*

⁶*The Ontario Budget 1985*, Ministry of Treasury and Economics.

⁷*Focus Ontario Survey*, Environics Research Group, April, 1986.

⁸Lance H.K. Secretan, *Managerial Moxie*, Holt Rinehart and Winston, Toronto, 1986, p. 226.

⁹Joseph A. Schumpeter, *The Theory of Economic Development*, England, Oxford University Press, 1974, p. 66.

3

The Job Creation Record of Small Business

3.1 Job Creation in the United States

The remarkable transformation of the United States from a managerial to an entrepreneurial economy is being repeated in Canada. It is resulting in record levels of job creation in both countries.

Between 1970 and 1980, small businesses in the United States created 20 million new jobs. Between 1981 and 1984, three million jobs were lost by the "Fortune 500" companies, while firms that were 10 years old or less contributed 750,000 new jobs and employment for one million additional people. The additional 250,000 jobs are a result of a multiplier or ripple effect. Excluding the agricultural sector, some 6.4 million jobs were created in the U.S. economy between 1982 and 1984.

The dynamic changes of the period 1976 to 1982 are shown in Table 3.1.1 and in Chart 3.1.1. Although large businesses increased their workforces by 5.3 percent in this period, the small businesses outpaced them two to one by adding 11.4 percent more jobs.¹

Our experience in Canada parallels that of the United States, where the majority of net new jobs were created by firms employing fewer than 50 people between 1976 and 1982.

Chart 3.1.1 *Net Job Creation by Size of Firm, United States, 1976-1982²*

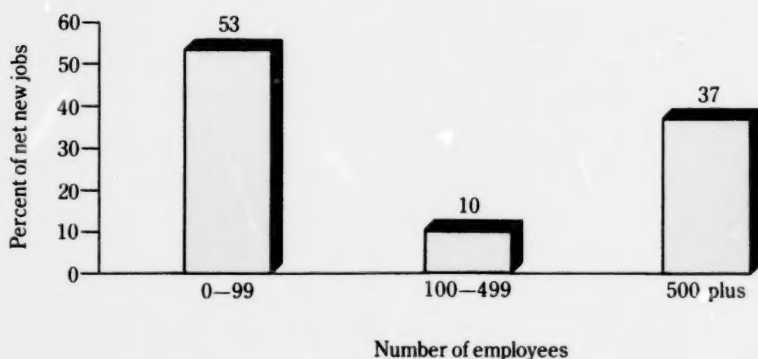


Table 3.1.1 *Change in U.S. Employment by Sector and Size of Workforce, 1976-1982*³

	Total	Number of Employees (000s)			
		< 20	20-99	100-499	500 +
U.S.	11,871.0	4,574.7	1,676.4	1,160.6	4,459.3
Small business dominated	8,608.0	3,141.3	1,110.8	925.8	3,430.4
Agriculture	42.5	89.7	-15.2	-12.2	-19.7
Construction	359.0	486.7	-24.0	-92.9	-10.7
Wholesale	756.7	513.0	101.6	77.9	64.3
Retail	2,192.3	490.2	327.0	262.6	1,112.5
Services	5,257.5	1,561.7	721.4	690.4	2,284.0

3.2 *Job Creation in Canada*

The creation of employment that adds dignity to the individual and value to the community has long been a social and economic imperium of Canadian policy makers at every level. The White Paper on Employment and Income in April, 1945, referred to the aspiration of providing a "... high and stable level of employment and income" for Canadians. In those days, nearly five million of Canada's 12 million citizens were employed, compared to 3.7 million prior to the war.

Between 1945 and 1955, unemployment averaged 3.2 percent, moving up to an average of five percent in the years preceding the oil crisis of 1973. Except for 1958, when employment shrank through the loss of 25,000 jobs, the numbers of Canadians employed grew every year until the 1981 recession. Canada's job creation record exceeded that of any other industrial nation between 1972 and 1982, with the creation of 2.3 million new jobs, a cumulative increase of 27 percent.

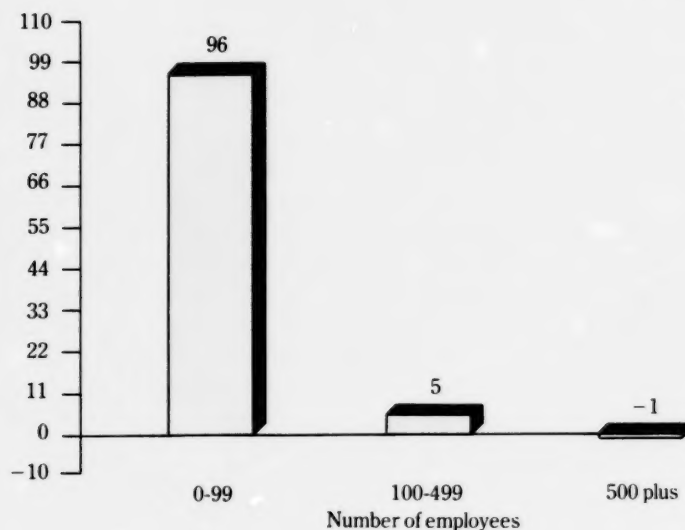
The 1981 recession heralded the end of this enviable record and a painful reappraisal of conventional wisdom concerning the sources of employment and job creation. In 1982 alone, 350,000 jobs were lost. The Keynesian pump-priming policies and programs previously used so successfully by federal and provincial governments appeared to be ineffectual.

The federal government has recognized that "... small business is the engine of economic growth."⁴ The Canadian small business sector is often defined as those firms with up to \$2 million in annual sales and /or employing fewer than 50 employees. By this definition, some 750,000 small businesses account for 96 percent of all Canadian firms and, although the majority of them employ fewer than 20 people, they account for 26 percent of all employment. Between 1978 and 1984, they accounted for 96 percent of the net new job creation across the country. The 1978 to 1984 period is highlighted in Chart 3.2.1.

This is a worldwide trend that has impacted strongly on Canada. Between 1978 and 1982, firms with fewer than five employees accounted for 96.5 percent of all jobs created in the private sector.⁵ Start-up companies created 40 percent of all new job opportunities in Canada from 1978 to 1982, demonstrating the crucial actual and potential impact they make on wealth creation and the reduction of current unemployment levels.

For Canada's youth, small businesses are a rich source of job opportunities. Although 52 percent of employed Canadians work in medium and large companies, these firms only provide employment to

Chart 3.2.1 *Net Job Creation by Size of Firm, Canada, 1978-1984⁶*

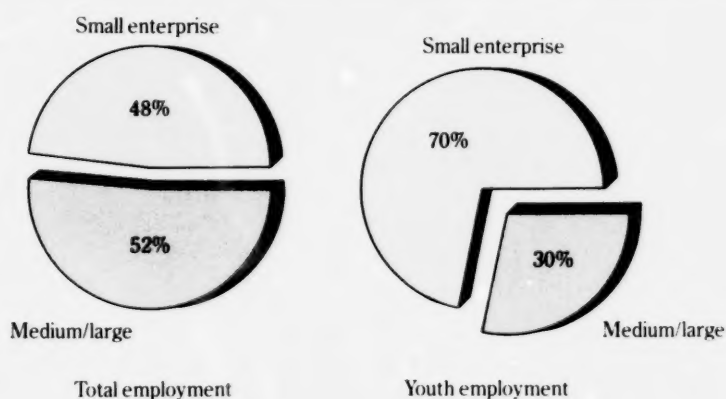


30 percent of those under 25 years of age. Small businesses, on the other hand, account for only 48 percent of total employment but employ 70 percent of young Canadians. More and more young Canadians are turning to entrepreneurship and new business start-ups as a viable alternative to traditional employment and, in some cases, economic inactivity. Chart 3.2.2 shows where Ontario's youth is employed.

The service industries produced the majority of the new jobs during the years 1978 to 1982, with business services and community services producing 16.6 percent and 14.8 percent of the new jobs respectively. Firms with fewer than five employees experienced employment increases of 65.4 percent, while firms with 20 to fewer than 100 employees and 100 to fewer than 200 employees experienced declines in the levels of paid employment of 1.7 percent and 0.5 percent respectively.

Notable employment growth took place in public administration, mining and manufacturing firms with fewer than five employees, where increases in employment were experienced of 206.4 percent, 182.0 percent and 110.4 percent respectively. Although the manufacturing sector experienced a decline in the level of paid employment of 3.6 percent during this period, companies with fewer than 20 employees regis-

Chart 3.2.2 *Jobs for Youth in Ontario, 1984 (percent)*⁷



tered healthy gains. The proportion of the total employment in firms with fewer than five employees grew from 7.8 percent in 1982 to 10.9 percent in 1984. Tables 3.2.1 and 3.2.2 look at both net employment change and percentage share of job creation by size of company.

Firms with fewer than 20 employees created 53.5 percent of all new jobs in Canada between 1982 and 1984. Once again, the business service sector was a major job generator, with firms with fewer than five employees accounting for 17.1 percent of the new jobs created and similar sized retail companies creating 12.3 percent of the increase in paid employment.

The positive employment picture in small businesses continues today. A recent survey of Canadian Federation of Independent Business (CFIB) members indicates that in 1986, 25.4 percent of those surveyed planned to expand their workforces, 5.2 percent planned employment cutbacks and 64.4 percent planned to remain at current staffing levels.⁸

Table 3.2.1 *Net Employment Changes by Firm Size and by Industry, Canada, 1978-1982*¹⁰

Industry	Firm Size					
	Fewer than 5	5 to < 20	20 to < 100	100 to < 200	200 to < 500	500 or more
Primary	14,208	-1,641	-1,986	-1,238	X	X
Mining	4,510	7,359	2,177	1,800	-1,156	7,217
Manufacturing	28,503	14,392	-3,518	-16,863	-31,062	-62,892
Construction	11,732	-14,616	-12,659	-5,470	-3,310	3,511
Transportation	18,156	1,480	-449	-454	-1,450	26,277
Wholesale trade	25,318	6,299	-5,893	418	-910	-1,771
Retail trade	66,356	18,817	4,879	-5,301	13,760	62,966
Finance	19,313	1,104	-307	6,635	8,237	17,387
Community services	44,093	21,564	10,831	11,292	45,569	74,581
Business services	98,566	34,590	12,283	11,896	36,411	15,861
Total*	344,185	97,783	7,959	4,422	68,968	142,473
						665,791

Note: X indicates data not available due to confidentiality. * Total includes unclassified.

Table 3.2.2 Percentage Share of Job Creation by Firm Size and by Industry, Private Sector, Canada, 1978-1982¹¹

Industry	Firm Size					All sizes
	Fewer than 5	5 to <20	20 to <100	100 to <200	200 to <500	500 or more
Mining	2.1	-0.2	-0.3	-0.2	X	X
Manufacturing	0.7	1.1	0.3	0.3	0.2	1.1
Construction	4.3	2.2	-0.5	-2.5	-4.7	-9.4
Transportation	1.8	-2.2	-1.9	-0.8	-0.5	0.5
Wholesale	2.7	0.2	-0.1	-0.1	-0.2	3.9
Retail	3.8	0.9	-0.9	0.1	-0.1	-0.3
Finance	10.0	2.8	0.7	-0.8	2.1	9.5
Community services	2.9	0.2	0.0	1.0	1.2	2.6
Business services	6.6	3.2	1.6	1.7	6.8	11.2
Public administration	14.8	5.2	1.8	1.8	5.5	2.4
Total	51.7	14.7	1.2	0.7	10.4	21.4
						100.0

Note: X indicates data not available due to confidentiality. Total includes unclassified.

3.3 *Job Creation in Ontario*

In 1982, Ontario enjoyed 38.9 percent of Canada's employment. In that year, Ontario's private sector employment growth rates did not equal the national average, as shown in Table 3.3.1.⁹ Ontario's manufacturing sector is proportionately larger than other provinces, making it more susceptible to economic vicissitudes, and the relative size and previous vigour of Ontario's economy made the continuance of sizeable year-on-year employment gains difficult to maintain.

Though Ontario's growth in employment from 1978 through 1982 was marginally below the country's average, this picture has since improved. A study of CFIB members suggests that the flow of jobs from Ontario to the West has ended. The highest proportion of those small business firms expecting to increase their employment in 1986 was recorded by Ontario (28 percent), compared to Alberta (23.1 percent) and British Columbia (22 percent). The national average was 25.4 percent.

Ontario also led in the proportion of CFIB members planning increases in capital investment (35.7 percent) and investment in working capital (32.8 percent). The national averages were 31.6 percent and 29 percent respectively.¹⁴

The service sector was a particularly strong performer. It increased its share of Ontario's net domestic product from 50 percent in 1972 to 62 percent in 1983 and generated 40 percent of all of the new jobs created in Ontario from 1974 to 1982. From 1974 to 1982, Ontario made the largest contribution to new service sector jobs in Canada (26 percent), followed by Alberta (25.6 percent). Firms that provide services to other businesses posted an employment growth rate of 67.8 percent over the last 10 years (more than three times the national average of 19.4 percent).

This continuing shift towards an information and services based economy is a trend that is even more advanced in Ontario, as can be seen in Table 3.3.2. Table 3.3.3 points out the hiring intentions of firms starting up in Ontario by sector.

Table 3.3.1 Percentage Change in Employment — Ontario and Canada, Private Sector, 1978-1982¹²

	Firm Size					
	Fewer than 5	5 to <20	20 to <100	100 to <200	200 to <500	500 or more
Ontario	64.8	3.4	-1.1	-1.9	8.4	1.0
Canada	68.0	2.8	-3.7	-4.6	5.7	1.2
						6.3
						6.4

Table 3.3.2 Percentage of Net Employment Change by Industry, Canada, 1978-1982¹³

Industry	Fewer than 5	5 to 20	20 to 100	100 to 200	200 to 500	500 and more	All sizes
Primary	37.9	-7.8	-16.4	-18.7	X	X	8.9
Mining	147.4	102.2	29.5	26.6	3.7	6.1	14.0
Manufacturing	81.6	12.6	-2.2	-10.8	-6.8	-5.6	-3.5
Construction	13.6	-13.7	-16.8	-11.4	-4.0	5.8	-4.5
Transportation	69.4	3.2	-1.2	-1.4	-1.9	5.5	6.2
Wholesale	56.2	5.9	-6.2	0.6	-0.8	-2.1	4.6
Retail	48.7	8.0	3.9	-6.9	13.2	15.5	14.9
Finance	45.3	1.9	-0.8	27.0	12.4	5.4	9.5
Community services	78.0	48.5	20.5	18.2	17.7	9.6	16.7
Business services	64.6	13.5	6.5	9.5	18.5	5.7	17.5
Total	54.3	9.8	1.0	0.7	4.9	3.9	8.2

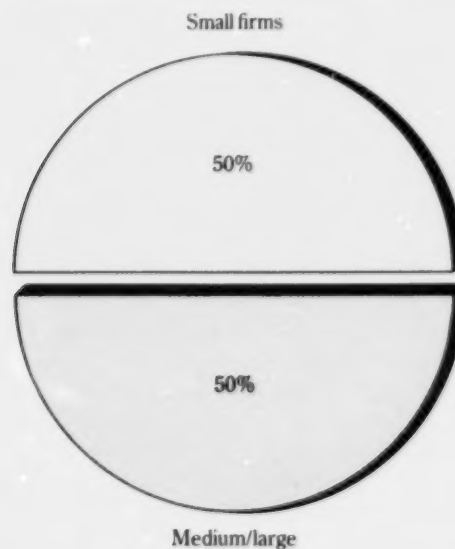
Note: Unclassified is included. X indicates data not available due to confidentiality.

Table 3.3.3 *Expected Job Creation by New Start-ups by Sector, Ontario*¹⁵

Sector	Not hiring %	Hiring %
Manufacturing	66	34
Service	70	30
Retail	61	39
Total	68	32

Statistics Canada recently reported that between 1978 and 1984, the small business sector accounted for 82 percent of net new job creation in Ontario, large companies accounted for seven percent of job creation and medium sized firms gained 11 percent of net new employment. Small business in Ontario accounted for approximately 50 percent of all private sector employment in 1984 (the latest year for which statistics are available — see also Section 4.2).¹⁶

Chart 3.3.1 *Employment by Size of Firm, Ontario, 1984*¹⁷



3,400,000 private sector jobs

Chart 3.3.1 is a graphic representation of jobs by firm size in 1984, while Chart 3.3.2 looks at job creation in Ontario for the 1978 to 1984 period and Tables 3.3.4 and 3.3.5 track employment in small business between 1982 and 1985.

Both the incorporated and unincorporated small businesses that have survived since registration show a strong capability for employment creation, and this trend is consistent over time, as can be seen in Table 3.3.6.

Chart 3.3.2 *Net Job Creation by Size of Firm, Ontario, 1978-1984*¹⁸

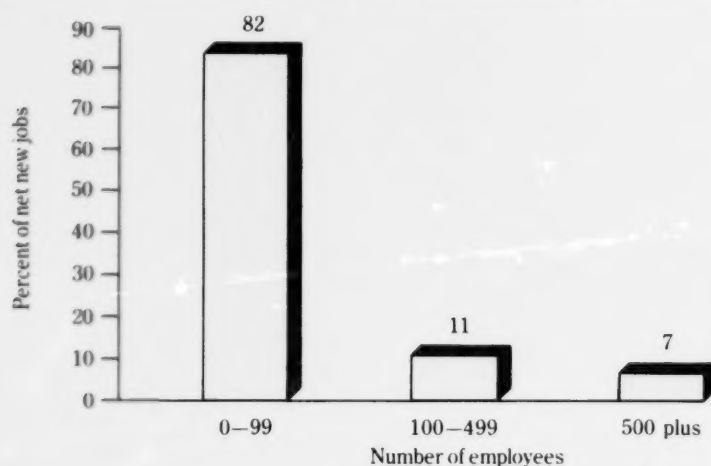


Table 3.3.4 *Average Number of Employees in Recently Registered Firms (at Start-up) in Ontario*¹⁹

	Incorporated		Unincorporated	
	#	%	#	%
At start-up	3.44		1.87	
of which...				
Number and % of women	1.59	46	0.83	44
Number and % of men	1.85	54	1.04	56
Number and % under 30	1.57	46	1.06	57
Number and % over 30	1.87	54	0.81	43
Number and % full time	2.76	80	1.43	76
Number and % part time	0.68	20	0.44	24

Table 3.3.5 *Average Number of Employees in Recently Registered Firms in Ontario (at Present)*²⁰

	Incorporated		Unincorporated	
	#	%	#	%
At present	7.52		3.75	
of which...				
Number and % of women	3.26	43	1.64	44
Number and % of men	4.26	57	2.11	56
Number and % under 30	3.55	47	2.19	58
Number and % over 30	3.97	53	1.56	42
Number and % full time	5.96	79	2.43	65
Number and % part time	1.56	21	1.32	35

Table 3.3.6 *Average Number of Employees in Firms Registered from 1982 in Ontario*²¹

	Incorporated %			Unincorporated %		
	1982	1983	1984	1982	1983	1984
Number of employees at start-up	2.1	3.0	4.7	1.8	1.8	2.0
Number of employees currently	6.1	7.4	8.6	3.0	3.8	4.1

Chapter Notes

¹The U.S. Small Business Administration, Office of Advocacy, defines a business sector as small business dominated where 60 percent or more of the sales or employment are accounted for by firms with fewer than 500 employees.

²The U.S. Small Business Administration, *The State of Small Business*, May, 1985.

³Ibid.

⁴"Government Extends Financing Support to Small Business," *News Release*, Department of Regional Industrial Expansion, January 23, 1985.

⁵*An Analysis of Job Creation Based on the Regional and Sectoral Data Base 1978-1982: Phase I: Preliminary Report*, Department of Regional Industrial Expansion.

⁶Ministry of Industry, Trade and Technology, internal research based on 1984 Statistics Canada data.

⁷Ibid.

⁸*CFIB Survey of Business Conditions: THE HARD FACTS*. Canadian Federation of Independent Business, January, 1986.

⁹*An Analysis of Job Creation...Regional and Sectoral*, Op. Cit.

¹⁰*An Analysis of Job Creation Based on the T4 Employment Estimates Data Base 1978-1982*, Department of Regional Industrial Expansion.

¹¹Ibid.

¹²*An Analysis of Job Creation...Regional and Sectoral*, Op. Cit.

¹³*An Analysis of Job Creation...T4*, Op. Cit.

¹⁴CFIB, Op. Cit.

¹⁵Ministry of Industry, Trade and Technology, internal research undertaken at the Companies Branch of the Ministry of Consumer and Commercial Relations.

¹⁶*An Analysis of Job Creation...Regional and Sectoral*, Op. Cit.

¹⁷Ministry of Industry, Trade and Technology, internal research based on 1984 Statistics Canada data.

¹⁸Ibid.

¹⁹Ministry of Industry, Trade and Technology, internally commissioned research by the Creative Research Group.

²⁰Ibid.

²¹Ibid.

4 The Growth of Small Business

4.1 Analysis by Sector — The 10 Year Trend

The Manufacturing Sector

Of the 724,000 businesses registered in Canada in 1978, only 45,000 were in the manufacturing sector. More than 39,000 (87 percent of the total) enjoyed annual sales of less than \$2 million and were therefore classified as small businesses, and the 5,000 manufacturers that attained a sales volume of more than \$2 million but less than \$20 million were classified as medium sized (11 percent of the total). Just two percent of Canadian manufacturing companies were classified as large companies, being in an annual sales class of more than \$20 million.

As Table 4.1.1 demonstrates, the total number of manufacturing establishments grew by 12 percent between 1971 and 1980, with industries such as rubber and plastics, metal fabricating, machinery, transportation equipment, electrical products and non-metallic minerals showing an increase of 20 percent or more. The food and beverage, textile, clothing, wood and chemical industries grew at rates of less than 10 percent.¹

During the 1970s, the share of total manufacturing employment accounted for by small firms rose from 18 percent to 18.5 percent while the share claimed by medium sized manufacturing companies declined from 27.3 percent to 26.7 percent during the same period. This growth of small firms occurred in two ways. In some sectors, such as printing, metal fabricating and machinery, where sector-wide growth has occurred, the smaller companies have grown even faster than the larger ones. In others, such as the leather, textile and electrical products industries, where sector-wide declines have occurred, the small firms' survival rate has been superior to that of the larger firms, resulting in their decline being relatively less severe.

Ontario accounts for 34 percent of all manufacturing establishments in Canada, over 60 percent of Canada's manufacturing sales and 52 percent of Canadian employment in manufacturing.

One recent study showed that while employment in manufacturers existing in 1971 fell 3.6 percent during the following 10 years, manufacturing companies with between 10 and 100 employees increased their employment by 0.9 percent, and that these small companies were the only group to increase employment over that period.²

Table 4.1.1 *Number of Manufacturing Establishments by Size of Establishment³*

Group	Number of establishments in 1980			Change since 1971			Total
	Small	Medium	Large	Small	Medium	Large	
Food and beverages	3,727	695	245	-21	2	17	-17
Rubber and plastics	736	190	54	55	44	35	52
Leather	296	108	27	-4	20	4	9
Textiles	703	155	90	7	4	3	4
Knitting mills	168	86	27	9	18	7	14
Clothing	1,605	457	81	1	10	13	1
Wood industries	2,809	424	130	4	16	50	7
Furniture	2,097	235	37	9	17	16	10
Paper and allied	379	235	150	28	26	-5	19
Printing & publishing	3,882	303	77	17	13	25	17
Primary metals	240	124	96	8	13	34	14
Metal fabricating	4,366	595	125	24	19	4	23
Machinery	1,175	320	106	81	73	36	76
Transportation equipment	955	216	131	40	33	13	36
Electrical products	701	253	138	67	21	3	43
Non-metallic minerals	1,345	175	52	24	2	11	21
Chemicals	880	233	99	6	8	17	7
Misc. manufacturing	2,522	225	51	18	13	0	17
Total	28,586	5,029	1,716	11	18	14	12

Table 4.1.2 *Number of Tertiary Sector Establishments by Size of Establishment**

Group	Number of establishments in 1979			Change Since 1976 %		
	Small	Medium	Large	Small	Medium	Large
General contractors	20,071	1,350	77	31	25	40
Special trade contractors	27,266	948	26	37	38	53
Transportation	14,388	795	90	33	55	41
Storage	494	35	5	-2	59	25
Communication	704	118	23	-2	23	35
Electrical, gas and water	637	44	34	-25	-60	-15
Wholesale trade	35,793	5,580	580	20	37	65
Retail trade	63,059	4,506	273	29	52	59
Finance industries	42,251	665	143	21	61	55
Insurance and real estate	60,470	905	67	20	50	60
Education and related services	760	11	1	28	57	-
Health and welfare services	4,055	57	3	84	123	5
Amusement and recreation	6,239	112	16	33	58	129
Business services	32,638	543	34	124	68	42
Personal services	5,241	58	2	26	61	100
Accommodation and food services	19,163	397	27	35	76	35
Misc.	13,353	331	15	34	43	25
						39

The Tertiary Sector

In the tertiary sector of the Canadian economy (those companies that are not members of the manufacturing or resource industries), the vast majority of firms are small businesses, being especially dominant in the service, construction and finance sectors. It is because of these demographics that small businesses have played such a pivotal role in fuelling Canada's recent economic performance. This is dramatically depicted in Table 4.1.2, which shows that nine of the 18 major tertiary groups experienced a growth rate of 30 percent or more while only one, electric, gas and water utilities, declined.

Table 4.1.3 *Small Business in Ontario by Sector, 1985⁵*

	< 50 employees		< 100 employees	
	#	%	#	%
Agriculture	20,437	6.9	20,483	6.8
Forestry	1,086	.5	1,105	.4
Fishing	294	.1	295	.1
Mining	784	.3	808	.3
Manufacturing	17,469	6.0	18,793	6.2
Construction	36,711	12.3	37,016	12.2
Transportation, communication and other utilities	10,485	3.5	10,722	3.5
Trade	71,087	23.9	71,975	23.7
Finance, insurance and real estate	23,426	7.9	23,631	7.8
Community, personal and business services	116,389	39.0	117,939	39.0
Total	298,186	100.0	302,767	100.0

Table 4.1.3 illustrates the growing proportion of small businesses accounted for by the community, personal and business services sectors (39 percent) and the concentration of these firms in the "under-50-employees" company size.

The service group (the last seven classifications in Table 4.1.2) represented the greatest employment growth, increasing 27 percent. This sector is dominated by small businesses, which had a total employment share of 73.2 percent in 1979. The combined sector grew by 47 percent between 1976 and 1979, with the total number of service companies growing by 69 percent and the small service businesses showing a surge of 124 percent and employing 67.4 percent of all the employees for the sector as a whole.

The \$5 billion contribution to GNP provided by small service businesses amounted to 47 percent of the sector total, rising 178 percent during the five year period. Eighty percent of employment in this sector is provided by companies having less than \$2 million in annual sales.

The growth of service companies referred to earlier is confirmed once again by the rate of their formation, depicted in Table 4.1.4. Over the three years, there was a growing tendency for manufacturers to incorporate upon formation, while more retailers favoured partnerships for their newly formed ventures.

Small businesses that provide services to other businesses are one of the fastest growth sectors of the economy. In the last 10 years, the number of staff employed in these firms has grown by 67.8 percent (297,000 to 498,000).⁶ This sector includes, among others, accounting, advertising, architecture, computer services, employment agencies, engineering and scientific services, law, management and business counselling, security and investigation and miscellaneous services to business management.

The driving force behind this phenomenon is the "demassing" of major corporations referred to earlier and the tendency to "functional externalization." This term refers to the growing practice of larger companies to subcontract their service functions as well as many support activities to outside specialists. This enables them to focus on their corporate mission by utilizing their strengths and distinctive intellectual competencies.⁷

While the manufacturing sector continues to grow, the size of the workforce employed in this sector is declining. This trend will accelerate as fully automated production becomes more widespread and robotic equipment the manufacturing standard. Thus the manufacturing sector will create substantial wealth in the decades ahead but account for less employment.

The labour intensive tertiary sector, on the other hand, will provide both increasing wealth and employment as the rapid introduction of affordable computer technology into these small businesses assists in the "demassing" of corporate units. This adaptation from financial capital intensiveness to "human capital" intensiveness characterizes the shift to a knowledge-based economy. More and more businesses will be home based, small, family owned units that used to be parts of major corporations until they were sold to the former employees who managed them.

The tertiary sector does not possess the regional differences of representation displayed by the manufacturing sector. The presence of tertiary sector companies generally follows the level of economic activ-

ity of each region. Exceptions are the wholesale and retail trades, which are largest in Ontario, where a larger share of consumers reside.

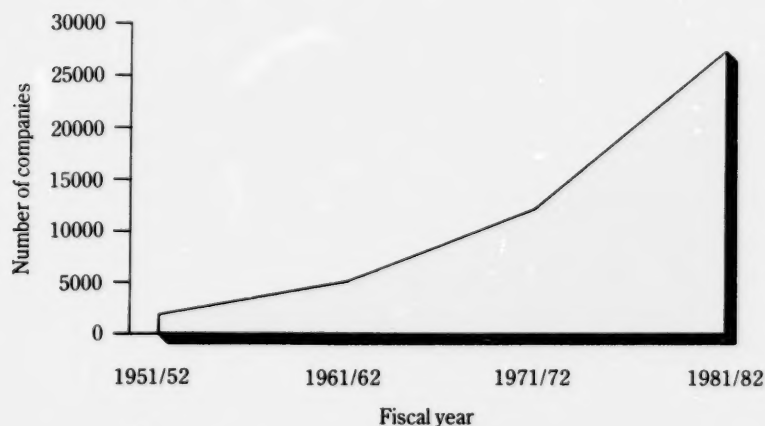
4.2 *Births, Deaths, Expansions and Contractions*

Job creation is a factor of the change in the size (and therefore the fortunes) of the firm. In order to lend greater understanding to the relationship between these two components, it should be pointed out that net employment changes can be caused by two main factors: growth in the number of firms or growth in the size of firms. The variation in employment caused by the number of companies can be further categorized by "birth"⁸ and "death,"⁹ while employment growth and decline caused by the changes in the sizes of firms can be categorized as "expansion" and "contraction."

Data on incorporated new business starts is available back to fiscal 1951/52. As the long-term trend shows in Chart 4.2.1, Ontario has enjoyed a long period of accelerating growth in the rate of incorporated business starts.

In a three-year study of business birth and mortality rates, it was found that new corporations represented 15 percent of the number of corporations on record for the immediately previous period.¹⁰ The report added that this growth rate is exceptionally high when compared with other economies such as those of the United States and Europe.

Chart 4.2.1 *Number of Companies Incorporated Annually in Ontario, 1951/52-1981/82*¹¹



The findings of the study show that two new corporations were started for each one that ceased business or was discontinued, yielding a net increase of 7.5 percent in the number of firms.

A recent survey estimates that during 1985, some five percent more businesses were formed than were closed. The survey suggests that business deaths were at a record low of 5.8 percent across Canada compared to 7.4 percent in 1984. According to this study, Ontario's performance led the nation, which by region posted the following closing rates for 1985 (1984 in parentheses): British Columbia and Alberta, 6.8 percent (10.3 percent); Saskatchewan and Manitoba, 5.8 percent (7.0 percent); Ontario, 5.2 percent (6.2 percent); Quebec, 5.9 percent (6.9 percent); Atlantic region, 6.3 percent (8.9 percent).¹²

One in nine of the discontinued firms had gone bankrupt. In 1981, 97.1 percent of bankruptcies reported balance sheet assets of less than \$250,000 and 55 percent to 65 percent of these companies had been in business for less than five years. Finally, this study reported that the greatest concentration of failure typically occurred in the third year, the frequency of failure declining progressively until the 10th year, when it became minimal but not insignificant.

Between 1978 and 1982, the change in employment levels was due less to the size of firms (contraction and expansion) than to the number of firms (births and deaths). With the exception of primary industry, the net employment change of 7.9 percent was due mostly to the change in the size of firms (7.3 percent), with the change in the number of firms playing only a minor part in this increase (0.6 percent). In manufacturing and construction, the declines in employment were due mainly to the low birth rate and high death rate of firms in these two sectors.

The interdependent relationship between changes in the size of firms and job creation can be seen from the data in Tables 4.2.1 and 4.2.2. Of special note is the contribution of small firms to job creation.

For firms employing fewer than five employees, the 65.4 percent growth in employment between 1978 and 1982 was more a result of births and deaths than expansion and contraction of firms. Of the 400,167 net new jobs created in 1982 by firms with fewer than five employees, 402,291 jobs were the result of new businesses and 264,549 jobs were created by the expansion of existing firms. Death or contraction of firms caused the loss of 180,491 and 86,182 jobs respectively. The closure of firms with more than five employees caused the loss of more jobs than were created by new start-ups, but the expansion of existing firms caused a net increase in employment.

Table 4.2.1 *Components of Job Creation by Industry, Canada, 1978-1982¹³*

Industry	Changes in number of firms %				Changes in size of firms %		
	Total net change	Birth	Death	Net change	Expansion	Contraction	Net change
Primary	7.1	28.2	19.9	8.3	19.1	20.4	-1.3
Mining	22.6	11.7	-5.9	5.8	32.3	-15.5	16.8
Manufacturing	-3.7	6.3	-9.1	-2.8	12.4	-13.3	-0.9
Construction	-5.8	17.1	-20.9	-3.8	20.5	-22.4	-1.9
Transportation	3.9	5.9	-6.2	-0.3	11.8	-7.7	4.1
Wholesale	6.0	13.2	-13.6	-0.4	20.7	-14.3	6.4
Retail	14.7	14.9	-13.1	1.8	23.1	-10.2	12.9
Finance	5.6	7.6	-9.8	-2.2	17.6	-9.8	7.8
Community services	14.8	4.2	-2.5	1.7	16.3	-3.2	13.1
Business services	16.6	21.4	-14.3	7.1	20.2	-10.6	9.6
Public administration	14.7	2.2	-1.2	1.0	18.2	-4.5	13.7
Total	7.9	9.7	- 9.1	0.6	17.4	-10.1	7.3

Table 4.2.2 Components of Job Creation by Firm Size, Canada, 1978-1982¹¹

Firm size	Changes in number of firms %			Changes in size of firms %		
	Total net change	Birth	Death	Net change	Expansion	Contraction
Fewer than 5	65.4	65.7	-29.5	36.2	43.2	-14.1
5 to <20	3.3	17.0	-18.6	-1.6	21.6	-16.7
20 to <100	-1.7	10.6	-16.2	-5.6	18.8	-14.7
100 to <200	-0.4	6.6	-12.3	-5.7	17.4	-12.2
200 to <500	8.4	5.7	-8.8	-3.1	21.9	-10.5
More than 500	4.6	1.8	-2.4	-0.6	11.9	-6.7
Total	7.9	9.7	9.15	0.6	17.4	-10.1
						7.3

Chapter Notes

¹Except where noted, the definitions of size used in this section are those used in the Census of Manufacturers — small: between one and 49 employees; medium: between 50 and 199 employees; and large: more than 200 employees.

²*Tracking Study of Small Manufacturing Establishments in Canada, 1971-1979*, Federal Business Development Bank.

³*Ibid.*

⁴*An Analysis of the Overall Contribution of Small Business to Economic Activity*, Small Business Secretariat, November, 1982, p. 44.

⁵Ministry of Industry, Trade and Technology, internal research based on Statistics Canada data.

⁶"Catering to Other Businesses — A Growth Area for Small Business," *Profits*, Federal Business Development Bank, Spring, 1986, Vol. 5, Number 4, p.2.

⁷Lance H.K. Secretan, *Managerial Moxie*, Holt, Rinehart and Winston of Canada, 1986, pp. 146-164.

⁸In this section, "Births" are firms that were formed after 1978 and still in operation in 1982.

⁹In this section, "Deaths" are firms that were in existence in 1978 but ceased operations before 1982.

¹⁰*An Analysis of the Overall Contribution of Small Business to Economic Activity*, Small Business Secretariat, November, 1982, p. 60.

¹¹Ministry of Industry, Trade and Technology, internal research.

¹²*Mandate*, #123, Canadian Federation of Independent Business, April, 1986.

¹³*An Analysis of Job Creation Based on the Regional Sectoral Data Base 1978-1982: Phase I: Preliminary Report*, Department of Regional Industrial Expansion.

¹⁴*Ibid.*

5 Profiles of the Small Business Owner

5.1 The Demographics of Owners

During 1986, research was commenced by the Ministry of Industry, Trade and Technology to measure the regional distribution and annual rate of new business formations in Ontario. Data was collected during part of the year to determine the number of new unincorporated business registrations. (The number of new unincorporated businesses registered each year usually outpaces new incorporated registrations by a ratio of two to one.) By extrapolating this information, some tentative conclusions may be reached concerning the probable annualized rates of unincorporated business formations per 1,000 population in Ontario, as seen in Table 5.1.1.

Table 5.1.1 *Business Starts per 1,000 Population by Region, Ontario, 1986¹*

	Number of businesses	Population	Business/1,000 population ‰
Metro Toronto	30,590	2,138,000	14.3
Central	25,200	3,350,000	7.5
South East	6,860	1,223,000	5.6
South West	4,410	1,282,000	3.4
North East	2,380	591,000	4.0
North West	560	237,000	2.4

In the summer of 1985, the Creative Research Group Limited presented the results of a research project undertaken on behalf of the Ministry of Industry, Trade and Technology. The owners of 861 businesses were interviewed (501 incorporated and 360 unincorporated). The purpose of the project was to produce a profile of the kinds of businesses these two groups formed between 1982 and 1984, measure the survival rates and generate other attitudinal and general demographic data about Ontario's small business owners.

The total sample group provided a good profile of new business owner demographics. Seventy-seven percent of the new business own-

ers are males, 23 percent are females; 48.4 percent of the owners are between 30 and 50 years old, only 6.1 percent are over 50 and the rest, 45.5 percent, are under 30. More detail may be found in Tables 5.1.2 and 5.1.3.

Table 5.1.2 *Age of New Business Registrants in Ontario, 1985²*

	Female owners		Young owners		Owners with employees		All owners	
	#	%	#	%	#	%	#	%
Under 24	36	11.9	222	37.8	73	17.9	222	17.2
24-29	98	32.5	365	62.2	104	25.6	365	28.3
30-50	153	50.7	—	—	209	51.4	624	48.4
50 and over	15	4.9	—	—	21	5.1	78	6.1

Table 5.1.3 *Operative Location of New Business Registrants in Ontario, 1985³*

	Respondents %
Part of home	66
Leased space	29
Purchased space	3
Other	2

Age and Experience

Research into the role played by education in the success of entrepreneurs is generally unavailable in Canada and contradictory elsewhere. For example, a study of 64 presidents of smaller U.S. firms implied that there was a positive correlation between better education and entrepreneurial success.⁴

Another study, based on 150 successful entrepreneurs, revealed that a strong desire to achieve was more important than education.⁵ The number of entrepreneurs with higher education is increasing every year in Canada and the United States; in one study of 2,500 successful entrepreneurs, one percent had attended but not completed high school, 17 percent had obtained a high school diploma, 43 percent had a bachelor's degree, 30 percent had a master's degree and nine percent had a doctoral degree.⁶

Two researchers who studied a group of Canadian inventor/entrepreneurs and founders of technologically based companies found that nearly 60 percent of them had university degrees and that most of them

Table 5.1.4 *The Demographics of New Business Owners in Ontario, 1982-1984^a*

	Incorporated %	Unincorporated %
Male	81	73
Female	19	27
Age		
Under 30	14	27
30-50	68	65
50 and over	18	11
Education		
Less than high school	20	25
High school graduate	21	22
Post high school	23	26
University graduate	35	25
Household income		
Under \$25,000	19	33
\$25-\$35,000	19	27
\$35-\$50,000	22	26
\$50,000 and over	41	14
Average	\$39,000	\$33,000

had assumed managerial roles in large corporations after graduating, the majority starting their businesses between the ages of 35 and 40.⁷

Another research project, undertaken between 1982 and 1984, found that new business owners in Ontario tend to be male and generally in the age group between 25 and 44 across both unincorporated and incorporated businesses. Incorporating is preferred by more male than female owners and the owners of new unincorporated businesses tend to be members of households receiving a lower income. The owners of incorporated businesses are more likely to possess university degrees than those of unincorporated businesses. Table 5.1.4 provides a comparison of the two groups.

The Small Business Branch of the Ministry of Industry, Trade and Technology has been conducting research on small business formations in Ontario since 1984. Each year, on randomly selected days, a survey of new business registrants is conducted at the Companies Branch of the Ministry of Consumer and Commercial Relations (MCCR) in Toronto. The statistical base in 1984 was 1,027 and in 1985 it was 1,472. The demographics of the 1985 survey respondents are presented in Table 5.1.5.

Table 5.1.5 *The Demographics of New Business Registrants in Ontario, 1985^a*

Sector	Gender %		Age %			
	male	female	under 24	24 to 29	30 to 50	over 50
Manufacturing	2.96	.94	.55	1.17	1.87	.31
Service	59.36	15.37	13.11	21.47	35.52	4.61
Retail	14.43	6.94	3.51	5.62	11.09	1.17
Total	76.75	23.25	17.17	28.26	48.48	6.09

Owners of start-up companies surveyed in this study tended to form new businesses in fields in which they had previous experience. Although the majority of owners of both types of businesses had the "hands-on" experience of actually working in a similar firm previously, only a minority had owned a similar type of business. Table 5.1.6 compares the business experience of owners of incorporated and unincorporated businesses.

Thirty to 35 percent of new business owners studied had started businesses before, the incidence being slightly higher among incorporated firms than unincorporated ones. The track record of the owners of incorporated firms in bringing their former businesses through the birth stages to maturity was substantially better than that of the owners of unincorporated businesses. Of all the previous businesses started by owners registering new ventures, 28 percent did not survive.

Table 5.1.6 *The Previous Experience of New Business Owners, Ontario, 1982-1984*¹⁰

	Incorporated %	Unincorporated %
Previous experience in:		
this kind of business	81	75
other relevant business(es)	7	6
none	12	19
running a business	63	55
never run a business	37	45
Previous employment as:		
executive/manager/owner	46	36
professional	13	6
sales	9	9
clerical/other white collar	10	11
skilled labour	16	28
unskilled labour	3	4
student	2	3
other	1	3
Number of new businesses started before:		
1 (this one only)	64	71
2	15	15
3	9	7
More	12	7
Average number	2.3	1.9
Of which still active:		
None	30	50
1	38	28
2	13	11
More	19	11
Average number	1.6	1.1

5.2 Preparation

The majority of new business owners consulted their accountants and lawyers before starting their companies, and owners who incorporated consulted more than those who did not. Although some of these consultations may be caused by the act of incorporation, they result in the owners of incorporated businesses being better prepared before start-up by being more likely to have developed pro formas, arranging short and long term funding and creating written job descriptions.

They also tended to be more inclined to develop formal business plans than the owners of unincorporated businesses. Although half of them did not start with a formal business plan at all, more of the surviving incorporated business owners are still preparing a current business plan than the surviving unincorporated business owners. This is detailed in Tables 5.2.1 and 5.2.2.

Table 5.2.1 *The Consultation Undertaken by New Business Owners, Ontario, 1982-1984¹¹*

People contacted before start-up:	Incorporated %	Unincorporated %
Lawyer	60	44
Accountant	60	53
Someone in the same sort of business	49	54
Bank/financial institution	43	43
Supplier	40	37
Government	13	17
Market researcher	6	6

Table 5.2.2 *The Financial Preparation Undertaken by New Business Owners, Ontario, 1982-1984¹²*

Financial preparation before start-up:	Incorporated %	Unincorporated %
Kept financial records	97	99
Developed a financial statement	93	88
Talked to financial institutions about financing	52	41
Obtained a loan to start the business	44	44
Considering equity financing	24	14

Chapter Notes

¹Ministry of Industry, Trade and Technology, internal research.

²Ministry of Industry, Trade and Technology, research undertaken at the Companies Branch of the Ministry of Consumer and Commercial Relations.

³Ibid.

⁴John Dart, "The Development of a Classification System for Entrepreneurial Types," D.B.A. Dissertation, University of Colorado, 1971, p. 222.

⁵Orvis Collins and David G. Moore, *The Organization Makers: A Behavioral Study of Independent Entrepreneurs*, Appleton-Century-Crofts, New York, 1970, pp. 49-62.

⁶The Center for Entrepreneurial Management, New York.

⁷Christopher J. Maule and Isiah A. Litvak, "Entrepreneurial Success or Failure — Ten Years Later," *Business Quarterly*, winter 1980, pp. 68-78.

⁸Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

⁹Ministry of Industry, Trade and Technology, research undertaken at the Companies Branch of the Ministry of Consumer and Commercial Relations.

¹⁰Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

¹¹Ibid.

¹²Ibid.

6 Franchising

The U.S. Department of Commerce has called franchising "the wave of the future." Although franchising is not a new phenomenon, many of the most successful and fastest growing franchising companies were founded within the last 20 to 30 years. Franchises are the leading edge of small business in the Canadian economy.

A recent study estimated the volume of total sales undertaken through Canadian franchised units at nearly \$50 billion — over one-third of total Canadian retail sales.¹ Approximately half of this is accounted for by motor vehicle dealers, soft drink bottlers and service stations. The balance is predominantly to be found in food, retail non-food, home improvement and maintenance, business services, automotive and other service (travel, party, haircutting, suntanning) sectors. Research suggests that this latter group of companies will lead the franchise explosion.

Between 1981 and 1984, franchisors averaged annual sales growth of 15 percent, compared to 7.7 percent for the retail sales sector as a whole and total GNP growth of 7.4 percent. Fifty-three percent of all franchise units and 47 percent of franchised sales are located in Ontario. Quebec ranks next with 13 percent and 27 percent respectively. Sixty-one percent of all franchisors' head offices are located in Ontario, with B.C. claiming the next largest proportion of head offices with 13 percent.

The companies surveyed, which account for 10 percent of total Canadian franchise sales, expect revenues to increase by a further 50 percent between 1985 and 1989, compared to a projected 35 percent increase for the total retail sector and a 28 percent growth for total GNP during the same period. To achieve this growth, franchising companies are planning to open new franchised outlets at a faster pace than the 11 percent achieved in 1984. The food sector, for example, is projecting twice as many unit openings in 1989 as in 1984.

Ontario's performance reflects the trend to be found in the United States. In 1983, total U.S. franchise sales accounted for 10 percent of gross national product. By 1985, they had passed \$US500 million, accounting for 20 percent of gross national product and representing over one third of retail sales in the United States.²

A 1982 study of franchising in Canada found that 64 percent of independent owner/entrepreneurs possessed prior experience in the same industry, compared to only 11 percent of the owners of franchised com-

panies. The study reported that "...independents seem to be much better prepared to operate businesses on their own than do the franchisees, who seek a business where a large number of franchisor support services are provided as part of the franchise contract."³

The same study revealed that, even before franchise fees and royalties, the capital invested by franchisees starting up new businesses is nearly double that of independent entrepreneurs (\$100,000 versus \$57,000).

Finally, the same study yields some interesting data about the sources of information consulted by new owner/entrepreneurs. Independent entrepreneurs tend not to consult their advisors before making the start-up decision while prospective franchisees tend to exhibit the opposite tendency. (See also Section 5.2, "Preparation.") The independent entrepreneur is compared to the franchisee in Table 6.1.1.

Table 6.1.1 Sources of Information before Starting Business¹

Source	Independent %	Franchisee %
Lawyer	32 (2)	80 (4)
Accountant	27 (3)	63 (3)
Banker	36 (1)	66 (5)
Business associates	23 (4)	64 (6)
Other franchisors	7 (6)	51 (2)
Other franchisees	11 (5)	68 (1)
Consultant	2 (7)	7 (7)

(1) denotes "most useful," (2) "next most useful," etc., as rated by respondents.

These findings may account for the marked difference to be found between the failure rates of independently owned businesses and those that are franchisee-operated. U.S. research shows that during the first five years, 80 percent of independently owned start-ups fail while only five percent of their franchised counterparts fail in the same time period.⁵

The trend predicted by The Naisbitt Group in the United States may be seen in Table 6.1.2.

This heady growth is expected to be replicated in Canada, and the implications for future job creation could be significant. According to the Association of Canadian Franchisors, franchised companies already employ more than one million Canadians and, with annual growth projected at 15 percent, 150,000 new jobs per annum are in prospect, many in the youth sector, where unemployment levels have proven to be so stubborn.⁶

Table 6.1.2 Projected Growth of Top Franchises, 1985-1990

Business	Sales (in \$US billions)		Annual growth %
	1985	1990	
Restaurants (all types)	48.9	86.1	12.0
Retailing (non-food)	18.8	33.6	12.3
Hotels, motels, campgrounds	14.6	22.5	9.0
Convenience stores	12.3	19.4	9.5
Business aids and services	12.1	21.3	12.0
Automotive products and services	10.6	15.9	8.5
Retailing (food other than convenience stores)	10.4	15.9	7.0
Rental services (auto, truck)	5.3	8.9	11.0
Construction and home services	3.7	92.5	20.0
Recreation, entertainment, travel	1.8	6.6	29.0
Total top 10	\$US 138.5	238.1	11.5

Chapter Notes

¹"Franchising: The Current Situation," Association of Canadian Franchisors, Toronto, 1985.

²The Naisbitt Group, "The Future of Franchising: Looking 25 Years Ahead to the Year 2010," International Franchise Association, New York, December, 1985.

³Russell M. Knight, *A Comparison of Franchisees and Independent Entrepreneurs*, paper presented to the Second World Conference of the International Council of Small Business, Halifax, June, 1983.

⁴Ibid.

⁵"Franchising: The Current Situation," Op. Cit.

⁶Howard Rose, Presentation to the York University MBA Entrepreneurship Class, winter, 1986.

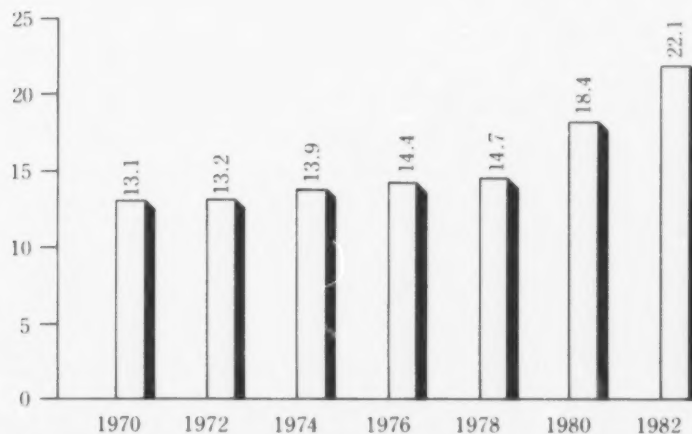
⁷The Naisbitt Group, Op. Cit.

7 Women Business Owners

7.1 The Profile of Women Business Owners

Owning and managing an independent business is difficult under any circumstances. But for women business owners, starting and operating an enterprise is even more difficult. As a result, female owned businesses accounted for only 4.6 percent of all firms in the United States in 1972.¹ But that is all changing: the number of self-employed women (in the United States) increased by 35 percent between 1977 and 1982 and the trend in Canada reflects the same pattern, which can be seen in Chart 7.1.1.

Chart 7.1.1 *Women Small Business Owners as a Percentage of all Proprietors, Canada, 1970-1982*²



A recent American study shows that the majority of women small business owners are between 40 and 45 years old.³ The Canadian demographics, as reported by a Ministry of Industry, Trade and Technology survey, are similar. Table 7.1.1 compares male and female business starters.

Table 7.1.1 *Male and Female New Business Owners Compared by Age, Ontario¹*

	Female %	Male %	Total %
Under 24	11.9	18.8	17.2
24-29	32.5	27.1	28.3
30-50	50.7	47.7	48.4
50 and over	4.9	6.4	6.1

The educational levels attained by male and female new business owners in Ontario are similar. Forty percent of male and 43 percent of female new business owners have a high school education, and 32 percent of women and 28 percent of men starting new businesses have completed a university level education. Also, the parents of female small business owners — particularly their fathers — are more highly educated than the general populace. The majority of female small business owners come from middle class families and have university degrees. Results of a study done in the United States are presented in Tables 7.1.2 and 7.1.3.

Table 7.1.2 *U.S. Women Small Business Owners, Social Class While Growing Up²*

	Women small business owners %
Lower class	6
Upper lower class	5
Lower middle class	19
Middle class	36
Upper middle class	28
Upper class	3

Table 7.1.3 *Educational Level of Canadian Women Small Business Owners⁶*

	% of respondents
Grade 10 or less	6
Grades 10 to 12	20
Grade 13	8
Trade school	3
College	27
University	36
Total	100

7.2 *Reasons Why Women Business Owners Start a New Business*

A 1978 survey of Canadian women business owners indicates that they started their own businesses because they felt restrained in the poor paying or low status positions in which they perceived themselves to be employed, desired to meet financial objectives but lacked the professional training to find a good job or were otherwise unable to find satisfactory employment. Twenty of the 98 surveyed suffered from "housewife's syndrome" — a strong desire to do something other than homemaking.

In studies performed in various locations across Canada since 1980, it has been found that women start new businesses primarily to experience the challenge of the entrepreneurial act or, secondly, to reach financial goals. Table 7.2.1 highlights the results of an Ontario study while Table 7.2.2 does the same for one in the United States.

Table 7.2.1 *Reasons for Starting a New Business — Male and Female Motivations Compared, Ontario, 1985⁷*

	Female %	Male %	Total %
Money	19.2	23.1	22.1
Be my own boss	22.5	18.2	19.2
Previous experience	14.2	17.1	16.5
Economic necessity	11.6	12.1	11.9
Product need	6.6	10.5	9.6
"Always wanted to do this"	10.6	6.4	7.4
Tax advantage	3.6	2.1	2.5
Right time	1.0	1.9	1.7
Other	9.9	8.2	8.6

Table 7.2.2 *Reasons Why Women Became Involved in Their Present Entrepreneurial Ventures (United States)**

Reason	% of respondents
Interest in area of business	44
Job frustration	42
Terminated	7
Divorced	6
Desire to run own business	6
Widowed	4
Moved	4
Money and career	4
It just evolved	4
Independence	4
Boredom	3
Time to do something new	3
Interest of another	3
Children left home	3
Inherited money	2

None of these reasons for starting a business is surprising when the relationship of women to the total work force is considered. For all the efforts and rhetoric surrounding equal pay for work of equal value and numerous other policy initiatives designed to overcome discrimination against women, progress has been slow. Starting a business is considered by many women to be one of the most promising avenues to effect their escape from clerical ghettos. The dimension of the challenge facing women in the workforce can be seen in Charts 7.2.1 and 7.2.2.

Chart 7.2.1 *The Earnings Gap Between Men and Women — Annual Income, Ontario, 1982⁹*

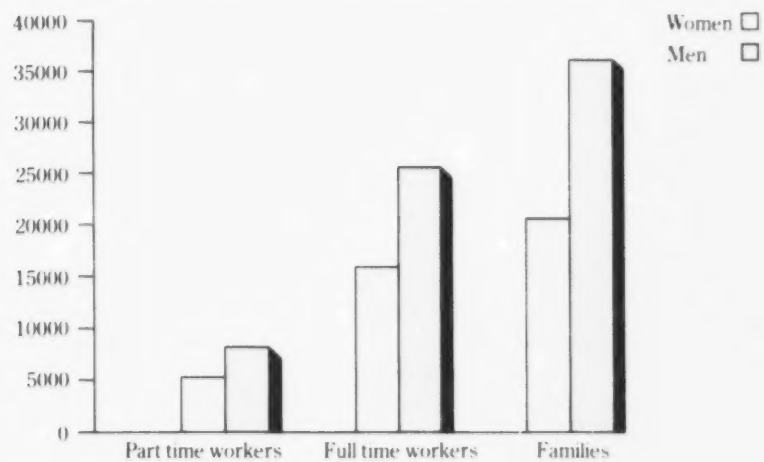
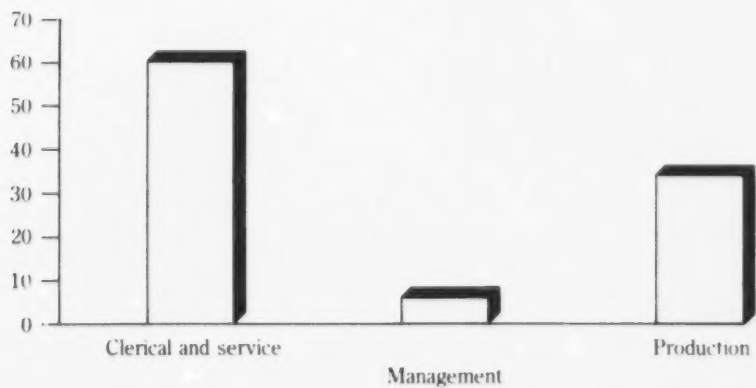


Chart 7.2.2 *Ontario Women at Work by Occupation, 1984¹⁰*



7.3 *The Sectors Favoured by Women Business Owners*

Women owners of small businesses tend to avoid those sectors that have traditionally been male dominated, such as manufacturing, choosing, instead, the service sector. This seems to reflect the educational and the past experiences of women entrepreneurs. The service sector is favoured by 66.1 percent of women owners of new businesses; 29.8 percent start retail firms and 4.1 percent start manufacturing businesses. As shown in Table 7.3.1, women are less likely to start service businesses and more likely to start retail businesses than men.

Table 7.3.1 *Comparison of Male with Female New Business Owners by Sectors Preferred, Ontario, 1985¹¹*

	Female owners %	Male owners %	Average %
Manufacturing	4.2	3.8	3.9
Service	66.1	77.3	74.1
Retail	29.8	18.8	21.4
Total	23.4	76.6	100.0

7.4 *Management Training and Assistance for Women Business Owners*

A recent U.S. study shows that women small business owners usually assess themselves as being adept at idea generation, product innovation and personnel skills; average in marketing and business operations; and poor in financial skills. All those surveyed claimed to have experienced difficulties during the start-up phases of their businesses. Two of the biggest problems, they claimed, were a lack of business training and a difficulty in obtaining lines of credit. In these disclosures may rest some normative guide to the direction that future government training and assistance for women should take.

It can be seen from Table 7.4.1 that women business owners consider their financial capabilities to be their weakest area of expertise, and some aspects of this weakness are reflected in Table 7.4.2, which describes the problems that U.S. women business owners face in operating their businesses.

Table 7.4.1 *Women Business Owners' Appraisal of Their Management Skills, United States, 1984*^{1,2}

Management skills	Poor %	Fair %	Good %	Very good %	Excellent %
Finance (forecasting, securing capital, budgeting)	15	32	27	15	6
People skills (management, development, training)	2	10	28	33	27
Marketing/sales (promotion, marketing research, selling)	6	20	20	33	22
Idea generation/product innovation	3	10	26	27	33
Business operations (inventory, production, day-to-day functions)	3	18	32	30	17
Organization and planning (business strategy, structure, policies)	4	15	29	29	23

Table 7.4.2 *Problems in Current Operations, United States, 1984*^{1,3}

Area	experienced by %
Lack of experience in financial planning	18
Other (attracting business, cash flow, hiring)	17
Demands of business affecting personal relationships	15
Weak collateral position	13
Obtaining lines of credit	11
Lack of business training	11
Lack of guidance and counsel	10
Lack of involvement with business colleagues	10
Lack of management experience	10
Lack of experience in use of outside services	9
Legal problems	5
Personal problems	4

A 1986 study of successful Canadian women entrepreneurs was produced by Jerry White at Laventhol and Horwath. He found, as exhibited in Tables 7.4.3 and 7.4.4, that women follow traditional sources of financing and that most are satisfied with the service provided by banks.

Table 7.4.3 *Women Entrepreneurs' Experience in Obtaining Financing for Growth, Canada, 1986¹*

	Approached %	Positive response %	Provided acceptable services %
Banks — Schedule A	89	79	74
Banks — Schedule B	11	89	84
Trust and insurance companies	7	90	64
Credit unions	8	90	79
Venture capitalists	12	25	91
Brokers — merchant bankers	4	25	87
Government including the FBDB	22	56	70

A 1984 study of 1,200 women small business owners sought to define the role of the government in women-owned businesses in Canada. Its recommendations suggest that the government should provide more assistance on an "outreach" basis. The report contends that women owners of small businesses need two kinds of management assistance. They seek process training, "how-to" information, during the start-up phase, and later, during the growth and maturity phases, they need "content" training.

Table 7.4.4 *Women Entrepreneurs Experiencing Discrimination, Received Poorer Levels of Service or Less Financing Compared to Men, Canada, 1986²*

	Discrimination %	Poor service %	Less financing %
Banks — Schedule A	21	28	28
Banks — Schedule B	14	12	10
Trust and insurance companies	33	34	34
Credit unions	15	10	10
Venture capitalists	44	21	33
Brokers — merchant bankers	35	22	31
Government including the FBDB	12	12	12

There appear to be four categories of training that would assist women entrepreneurs:

- plan the start-up of a new business;
- design and implement sales building and marketing;
- exercise adequate financial control;
- network between businesses.

The "process training" phase should contain:

- market research — "how to" collect data on industry, product and market potential;
- financial/accounting information — developing sales projections and cash flow forecasts for the first three to five years. Setting up the accounting system and methods of avoiding under-capitalization;
- marketing — techniques for promoting products/services in the most effective manner;
- information on government assistance programs — easier accessibility of information on the numerous programs;
- seminars on "how to start a business";
- how to obtain financing.

Once women small business owners feel that their businesses have emerged through the birth stage into the growth or mature stages, their needs change. They are more interested in "content" emphasis such as:

- financial help — bookkeeping, financial planning, cash flow forecasting, inventory control and general cost control;
- sales and profit forecasting techniques;
- business planning — setting objectives, identifying growth potential;
- marketing — advertising, merchandising, new product development, product mix determination and sales development.¹⁶

Chapter Notes

- ¹Robert D. Hisrich and Candida Brush, *Women and Minority Entrepreneurs: A Comparative Analysis*, paper presented to a conference on entrepreneurship, Hautes Etudes Commerciales, Montreal, April 1, 1986.
- ²Ministry of Industry, Trade and Technology, internal research based on Statistics Canada data.
- ³Robert D. Hisrich and Candida Brush, Op. Cit.
- ⁴Ministry of Industry, Trade and Technology, internal research conducted at the Companies Branch, Ministry of Consumer and Commercial Relations.
- ⁵Robert D. Hisrich and Candida Brush, Op. Cit.
- ⁶Dina Lavoie, *Comparative Profiles of Men and Women Entrepreneurs: Problems with the Meaning of Data and with Measurements*, paper presented to a conference on entrepreneurship, Hautes Etudes Commerciales, Montreal, April 1, 1986.
- ⁷Ministry of Industry, Trade and Technology, internal research conducted at the Companies Branch, Ministry of Consumer and Commercial Relations.
- ⁸Robert D. Hisrich and Candida Brush, Op. Cit.
- ⁹Ministry of Industry, Trade and Technology, internal research based on Statistics Canada data.
- ¹⁰Ibid.
- ¹¹Ministry of Industry Trade and Technology, internal research conducted at the Companies Branch, Ministry of Consumer and Commercial Relations.
- ¹²Robert D. Hisrich and Candida Brush, Op. Cit.
- ¹³Ibid.
- ¹⁴Jerry S. White, "The Rise of Female Capitalism — Women as Entrepreneurs," Laventhol and Horwath, April, 1986.
- ¹⁵Ibid.
- ¹⁶Lois Stevenson, "The Role of Government in Women-Owned Businesses in Canada," paper presented to the Third Canadian Conference, International Council for Small Business — Canada, Toronto, May, 1984.

8 The Aspirations and Achievements of New Business Owners

8.1 The Ambitions and the Outcomes

The degree of achievement aspired to by new business owners is very high at the time of registration, some of which may be fuelled by the euphoria of the event. The aspirations of those who incorporate are compared to those who do not incorporate in Table 8.1.1.

Table 8.1.1 *The Aspirations of Business Owners at the Time of Start-up¹*

	Incorporated %	Unincorporated %
Simply to make a living	38	52
To build a medium-sized company	5	5
To build a very large company	55	43

When the survivors of these new company registrations were asked about their aspirations one or two years later, their sights seem to have been adjusted to far more modest levels. However, there are distinguishing features between the surviving business owners when their ambitions are studied. For example, male, younger business owners and those who start with employees on their payrolls all seem to hold greater expectations for their ongoing ventures, and between one quarter (of unincorporated firms) and one third (of incorporated firms) expect to "... grow quickly — at least 50 percent annually."

Other more ambitious groups include incorporated retailers and unincorporated manufacturers, those with male owners and those who currently employ staff. A conservative estimate of future employment growth was offered by three-quarters of the sample surveyed, but one in eight of the unincorporated business owners and one in five of the incorporated business owners expect their staffs to grow by 50 percent or more. These future hopes are compared in Table 8.1.2.

Table 8.1.2 *The Expectations of Business Owners after Formation (Regarding the Future Number of Employees)*²

Number of staff employed will:	Incorporated %	Unincorporated %
decline	3	1
remain at start-up levels	13	23
grow slowly over time	63	54
grow by at least 50% each year	20	15
don't know	2	7

The actual outcomes compared to the original expectations of new business owners concerning employment levels can be derived by comparing Tables 8.1.2 and 8.1.3. The latter table shows that from the time of start-up, small businesses generally more than double the size of their labour force. For example, by 1985, incorporated companies that started in 1982 employed 2.9 people for each one employed in 1982. The job building ratio is more powerful in incorporated firms than unincorporated ones, but very significant in both.

Table 8.1.3 *Ratio of Number of Employees Now Compared to the Number at Start-up in Recently Registered Firms in Ontario*³

Incorporated %			Unincorporated %		
1982	1983	1984	1982	1983	1984
2.9	2.5	1.8	1.7	2.1	2.1

Table 8.1.4 *The Expectations of Business Owners after Formation (About Their Future Sales Performance)*⁴

Sales volume will:	Incorporated %	Unincorporated %
decline	3	1
remain at start-up levels	3	7
grow slowly over time	58	62
grow by at least 50% each year	33	26
don't know	3	4

But the rather higher expectations articulated by incorporated business owners at the time of formation seem to be borne out by subsequent performance, which is significantly better than that of their unincorporated peers. In 1984, the average sales for incorporated firms

formed in 1982 and 1983 was \$150,000, and for unincorporated firms the sales levels had reached an average of \$92,000.

The difference becomes even more pronounced when owners of firms that have survived since registration are asked to define their comfort levels in terms of company sales levels. The owners of incorporated businesses aspire to a sales level of \$572,000 per annum, while the definition of success will be met at \$307,000 for the owners of unincorporated firms, a difference of 281 percent more than current levels for incorporated firms and 234 percent for unincorporated firms. Tables 8.1.4 and 8.1.5 compare expectations and "success" levels respectively.

Table 8.1.5 *"What Level of Sales Will You Need to Reach in Order for You to Consider Your Business 'Successful'?"*^a

Dollars	Incorporated %	Unincorporated %
Under 25,000	1	1
25,000-50,000	2	12
50,000-100,000	7	16
100,000-200,000	15	23
200,000-500,000	21	17
500,000-1,000,000	15	9
1,000,000 and over	31	9

Within the time span of the 1982 to 1984 study, one in three of the owners of unincorporated companies decided to incorporate their firms.

8.2 Factors Constraining Small Business

One problem that small business owners usually put on a list of issues that they regard as an impediment to business and personal growth and success is government paperwork (see Chapter 10 for an extensive review of this subject).

The principle issue that seems to concern new business owners more, however, is the difficulty of acquiring qualified, skilled workers. When asked if they had at any time encountered the problems frequently articulated by other small business owners, the responses fell according to the distribution in Table 8.2.1 (the percent of respondents indicating that the issue was a major problem follows in parentheses).

Table 8.2.1 *"Have You Encountered any of the Following Problems in Your Business?" New Business Registrants, 1982-1984⁶*

	Incorporated %	Unincorporated %
Finding qualified/skilled workers	60 (35)	55 (37)
Government paperwork	53 (20)	42 (14)
Making sufficient profits	52 (20)	55 (19)
Finding customers	44 (14)	44 (14)
Municipal charges and taxes	44 (18)	36 (16)
Getting debt financing	41 (20)	33 (16)
The provincial tax system	39 (17)	32 (10)
The federal tax system	38 (18)	29 (12)
Raising equity capital	37 (18)	34 (14)
Payroll taxes, U.I.C., etc.,	36 (13)	24 (8)
Personal lack of management skills	35 (6)	36 (5)
Preparing marketing plans	28 (7)	24 (5)
Preparing financial plans	25 (6)	32 (9)
Dealing with labour laws	23 (6)	13 (2)
Getting information on how to start a new business	20 (5)	22 (5)

Chapter Notes

¹Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

²Ibid.

³Ibid.

⁴Ibid.

⁵Ibid.

⁶Ibid.

9 Small Business Financing

9.1 Sources and Availability of Capital

Sources of Funds

A characteristic of small businesses is under-capitalization. The initial capitalization of start-ups is often under \$5,000 and frequently this is generated from combinations of personal funds, investments of "non-bankable" owners' time (sweat capital) and the resources of friends and relatives (love money). The remaining financing needs are met by debt financing secured by personal as well as business assets.

The structure of small firms' balance sheets is far more likely to be characterized by short term liabilities than is that of their larger brethren. Recent research has shown that the smallest firms have a ratio of 55 percent liabilities to 45 percent equity, while large firms have a ratio of 41 percent liabilities to 59 percent equity. Table 9.1.1 details this. These balances between liabilities and equity are aggravated by the relationship between short and long term debt. The smallest firms carry 41 percent short term and 14 percent long term debt, whereas larger corporations have only 19 percent of their financing in short term debt.¹

In terms of financial performance, there is an irony in the fact that while the smaller firms create the majority of new jobs, a commensurate reward for this social contribution is not reflected in their financial results. As Table 9.1.2 shows, almost 60 percent of small firms fall outside "normal" rates of return on assets (0 to 16 percent), while only 23 percent of large firms do so.

A contributing factor to the poor profit performance of the small business sector has been the rising level and cost of debt. The interest burden (calculated as interest/profit before tax) has grown for companies of all sizes. From 1979 to 1984, the interest burden for large companies grew from 20 percent to 42 percent. However, among small and medium sized firms (SMEs), the interest burden grew from 35 percent to 62 percent during the same period. The interest burden of small firms has been some 50 percent higher than the large company experience but their profits have only been one-fifth and their profit margins one-third of those of the large firms.

As Table 9.1.3 shows, the ratio of interest burden to profits compares unfavourably with the universe of Canadian industrial corporations.

Table 9.1.1.1 *Distribution of Corporate Financing by Category of Instrument and Size of Firm Assets, Canada, 1981²*

	Assets (\$millions)					
	from .250 to .999 and less	from 1,000 to 4,999	from 5,000 to 9,999	from 10,000 to 24,999	over 25,000	
Liabilities	54.8	56.6	54.0	48.2	41.1	
Short term	41.2	42.0	39.0	33.4	19.3	
Long term	13.6	14.6	15.0	14.8	21.8	
Equity	45.2	43.4	46.0	51.8	58.9	
Shareholders' equity	44.8	41.4	43.1	48.2	51.9	
Deferred taxes	0.4	2.0	2.9	3.6	7.0	

Table 9.1.2 *Distribution of Independent Firms in Primary and Secondary Sectors by After-tax Rate of Return on Assets and Size of Assets, Canada, 1977^a*

	Assets (\$millions)					
	from .250 to .999 and less	from 1,000 to 4,999	from 5,000 to 9,999	from 10,000 to 24,999	over 25,000	
Negative rate of return						
0-8%	28.2	17.4	13.2	8.8	9.2	
8-16%	18.7	28.9	34.8	33.5	39.1	
Greater than 16%	22.8	28.9	37.1	38.0	37.4	
	30.3	24.8	15.1	19.7	14.4	

Table 9.1.3 Financial Characteristics of Industrial Corporations, Canada, 1979-1984^a

	1979	1980	1981	1982	1983	1984
Index of GNP (1977 = 1,000)						
All companies	1,176	1,307	1,446	1,591	1,683	1,723
Sales of SMEs						
Total sales	40.4	39.7	37.5	36.2	36.6	36.5
SMEs						
Sales	137,287	134,282	134,247	116,101	119,198	125,925
Profits	5,872	5,154	4,880	2,824	3,273	3,301
Interest paid	2,074	2,321	3,097	2,889	2,231	2,059
Profit margin	4.3	3.8	3.6	2.4	2.7	2.6
Interest burden	35.3	45.0	63.5	102.3	68.2	62.4
Large companies						
Sales	202,116	203,741	224,165	204,452	206,611	219,403
Profits	19,725	19,718	16,642	9,422	13,541	15,863
Interest paid	4,113	4,888	7,433	8,378	6,737	6,723
Profit margin	9.8	9.7	7.4	4.6	6.6	7.2
Interest burden	20.9	24.8	44.7	88.9	49.8	42.4
All companies						
Sales	339,402	338,023	358,411	320,553	325,809	345,328
Profits	25,598	24,871	21,522	12,246	16,814	19,164
Interest paid	6,187	7,209	10,530	11,268	8,968	8,782
Profit margin	7.5	7.4	6.0	3.8	5.2	5.5
Interest burden	24.2	29.0	48.9	92.0	53.3	45.8

Note: Companies are divided into those with assets of more or less than \$10 million. Profit margin is profit/sales; interest burden is interest paid/profits. Sales, profits and interest paid are in millions of dollars.

Venture Capital

Generally, the principal source of start-up financing is generated by what one team of researchers has called the "Uncle Harry" group. Uncle Harry is an individual who has been persuaded to invest in a venture because he is related to — or personally acquainted with — the principal of the venture and who has invested primarily because of this connection.⁵ A secondary source of funding is arranged through the formal venture capital market.

The Association of Canadian Venture Capital Companies includes over 35 companies, all of whom have a minimum of \$1 million in equity investments available for such investments. They may not invest more than 20 percent of these funds into any one enterprise and their investments are made with the clear understanding that they seek to liquidate the holding within a finite time period.

Membership includes private venture capital firms, the Federal Business Development Bank, the Ontario Development Corporation and several members of the chartered banking community such as the TD Capital Group, Roynat and Roymark. Some larger corporations, such as Northern Telecom Venture Capital Division and The Molson Companies Ltd., represent additional sources of venture funding and many "schedule B" banks also provide venture capital funding.

Some of the more frequently used sources of information about venture capital include *ABC Assistance to Business in Canada*, published by the Federal Business Development Bank and available "on line" at most of its branches, *Sources of Funds Index*, published by SB Capital Corporation Limited, and the *Canadian Business Magazine* annual survey of venture capital. In addition, most chartered banks and accounting firms will offer advice to entrepreneurs concerning sources of venture capital.

In practice, most of these companies will not invest funds of less than a given amount. These minimum levels are typically between \$100,000 and \$250,000, with some companies having lower limits of \$1 million. The average first-time investment by the members of the Association of Canadian Venture Capital Companies in 1982 was \$800,000. As one venture capitalist remarked recently, "I have to work as hard to set up a \$50,000 deal as I do a \$500,000 one." This attitude has caused many observers to conclude that the venture capital industry has not been geared to start-up investment.

A recent study of applicants that had been rejected by venture capital firms showed that most were trying to raise less than \$250,000.⁶ Another study showed that the reasons for rejection given by the venture capital firms are as shown in Table 9.1.4.

Table 9.1.4 *Venture Capitalists' Reasons for Rejecting Application*⁷

Reason	% of responses
Amount too small	17
Insufficient earnings	17
Inappropriate industry	13
Economy bad	10
Price too high	10
Deal too risky	10
Management not competent	6
Not interested	17
Total	100

Seventeen percent of these rejected applicants obtained financing from alternative sources, 15 percent of them from other venture capital firms. Only 10 percent stated that they had cancelled their project, lending credence to the generally accepted view that entrepreneurs who are strongly motivated eventually obtain start-up financing, regardless of the financial hurdles that are placed in their way. The alternative sources are shown in Table 9.1.5.

Table 9.1.5 *Other Sources Approached for Same Financing*⁸

Source	Approached	% of responses
Chartered bank	52	23
Individual investors	42	26
FDBD	40	15
Provincial govt. program	39	16
Federal govt. program	34	18
SBDC	27	11
U.S. sources	26	11
Private placements	24	13
Other (corporations & other institutions)	16	5

The Chartered Banks

In December, 1985, the CFIB released the findings of a poll of its members concerning banking relationships.⁹ Of the estimated 750,000 small businesses in Canada, 86.2 percent used a chartered bank as their primary source of financing and 78.1 percent banked with one of the "big five." At the end of the third quarter of 1985, the chartered banks reported \$15.9 billion in loans outstanding to small businesses (an increase of \$2 billion or 13 percent since 1982). Government guaranteed loans make up about 10 percent of the banks' small business loan portfolios. Small business and the major banks enjoy a relationship that is very important to both parties; indeed, loans to small business represent almost 25 percent of the banks' total lending portfolios.

Despite the strength of this relationship, more respondents expressed dissatisfaction with the five major chartered banks in 1985 than in 1982 (31.1 percent versus 27.9 percent).

In Ontario, according to the CFIB study, the "big five" small business market share was 93 percent. The National Bank accounted for 1.3 percent of market share (27.8 percent in Quebec, 6.5 percent nationally), other chartered banks 0.9 percent (5.8 percent in B.C., 5.6 percent in Alberta and 1.6 percent nationally), trust and finance companies 1.7 percent (1.0 percent nationally) and credit unions 2.4 percent (33.9 percent in Quebec, 17.4 percent in Saskatchewan, 12.9 percent in Manitoba, 12.7 percent in New Brunswick and 10.5 percent nationally).

Generally, respondents reported higher levels of satisfaction with credit unions (85.2 percent), trust and finance companies (83.9 percent) and other chartered banks (77.2 percent) than with the "big five" (68.3 percent). These perceptions may account for the fact that all but one of the major banks' share of the small business market had declined between 1982 and 1985, and the shift by small business towards credit unions and cooperatives, trust and finance companies and other financial institutions has accelerated during the same period.

Ontario, with more concentration of larger financial institutions than other regions, appears to sit at the lower end of the scale in Canada, with 69.4 percent of CFIB respondents claiming satisfaction with the financial and banking services received. This compares with P.E.I. 85.9 percent, Quebec 83.8 percent, Nova Scotia 79.8 percent, Manitoba 73.1 percent, New Brunswick 73.0 percent, Saskatchewan 71.6 percent, Newfoundland 69.5 percent, Alberta 65.9 percent, B.C. 59.8 percent and a national average of 71.7 percent.

The survey's findings indicate a positive correlation between the number employed in a firm and the general level of satisfaction with banking services, the smallest firms being more often dissatisfied.

The broadening of the services provided by regional banks and other financial institutions, together with the extension of competition proposed by several recent government discussion papers and bills (see Section 10.2), will almost certainly hasten the recent trend of financial institutions to court the small business owner/manager.

The shift from a manufacturing to a service and knowledge based economy has created certain puzzles for the banking and small business fraternities. Funding against the "hard assets" of small manufacturers is one thing, but start-ups in the service sector often only possess "soft assets" such as intellectual property rights, know-how or a team that has specialized skills that relate to a narrow market "niche" or specialization; bankers find these assets awkward to use as collateral and our financial system regards them warily.

The advent of the "post-industrial" era has ushered in a new wave of service companies whose owners tend to favor debt rather than equity capital for start-up purposes and who tend to seek more leverage than new manufacturing companies. This has created higher risks and vulnerabilities for the lending institutions.

9.2 *Initial Capital Formation*

The Creative Research Group study of 501 incorporated and 360 unincorporated businesses revealed that the average start-up funding of new firms in Ontario was \$27,000, and personal investment accounted for 68 percent of this amount for incorporated owners and 73 percent for unincorporated owners. The owners of incorporated firms invested more in their new businesses than the owners of unincorporated ones. See Table 9.2.1. (This may be compared to the average initial investment made into business start-ups by franchisees described in Section 6.1, "Franchising.")

Both the age of the owner and the number of staff to be employed in the new venture were correlated with the size of the initial investment. Older business owners tend to put more personal capital into a new business as a percentage of the total investment.

The relatively higher investment by males compared to females may add power to the critics of Canada's financial system who argue that it discriminates against women. The male owners of new incorporated companies invest an average of \$27,900 (female \$21,400), with \$18,900 (\$14,300) of this coming from personal sources.

Table 9.2.1 *The Amount of Funds Invested by New Incorporated and Unincorporated Business Owners in Ontario, 1982-1984*¹⁰

Start-up funds	Incorporated %	Unincorporated %
\$0-\$5,000	16	24
\$5,000-\$11,000	15	17
\$11,000-\$21,000	16	19
\$21,000-\$50,000	22	16
over \$50,000	28	18
Don't know/refused	3	6
Average start-up investment (000s)	\$26.7	\$20.8
... of which being your own money		
\$0-\$5,000	30	34
\$5,000-\$11,000	18	20
\$11,000-\$21,000	17	17
\$21,000-\$50,000	16	13
over \$50,000	13	9
Don't know/refused	6	7
Average (000s)	\$18.1	\$15.2

The primary sources of start-up funds are from within the personal resources of the new owners, with the principal secondary sources being banks and other financial institutions. Unincorporated firms lean more heavily on relatives as sources of start-up capital. Of the companies that had survived the three years since formation in 1982, about 50 percent had required additional funding for working capital and other needs and they had tended to turn first to banks and other financial institutions. Tables 9.2.2 to 9.2.4 outline the start-up and subsequent financial requirements and the sources that met the need.

Table 9.2.2 *Working Capital Requirements by Sector, Ontario, 1985*¹¹

Sector	Less than \$5,000 %	\$5,000- \$10,000 %	\$11,000- \$49,000 %	Over \$50,000 %
Manufacturing	2.0	1.0	.8	.1
Service	41.9	16.2	13.6	3.1
Retail	10.1	4.5	4.5	2.2

Table 9.2.3 *The Sources of Funds for New Incorporated and Unincorporated Business Owners in Ontario, 1982-1984*¹²

Start-up funds (beyond own money)	Incorporated %	Unincorporated %
All start-ups		
Banks/other financial institutions	28	25
Relatives	9	20
Friends	6	11
Other investors	9	6
Own money		
Partner	10	6
Self finance/own capital	13	11
Earnings/the business	3	2
Government	< 0.5	—
Other	< 0.5	1
Sources for additional funding (Those needing and successfully raising additional financing)		
Banks/other financial institutions	74	60
Relatives	13	18
Friends	6	13
Other investors	11	5
Own money		
Partner	2	1
Self finance/own capital	6	6
Earnings/the business	7	11
Government	1	4
Other	0	1

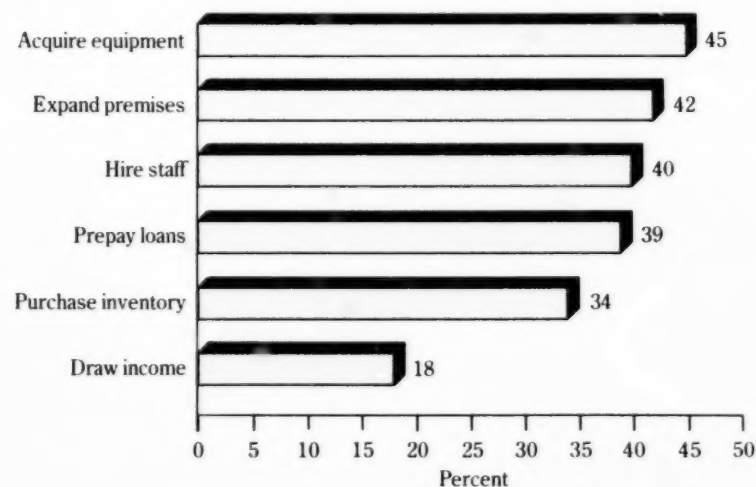
Table 9.2.4 *Sources of Funds by Sector, Ontario, 1985*¹³

Sector	Savings %	Bank %	Relatives/ friends %	Business %	Other %
Manufacturing	3.5	.1	0	.2	.2
Service	61.2	6.2	2.3	2.0	2.3
Retail	16.3	2.4	.9	.7	.9
Total	80.0	8.7	3.2	2.9	3.4

Financial experts and advisors frequently stress the importance of adequate funding prior to the formation of new ventures, but the Creative Research Group study implies that either this issue is well considered by most business owners before start-up or its importance has been overstated. Fully 46 percent of the owners of incorporated firms and 47 percent of the owners of unincorporated firms report that they have had no need of additional financing. Forty-one percent of incorporated owners and 40 percent of unincorporated owners needed additional capital and were successful in obtaining it and only 12 percent of incorporated and 13 percent of unincorporated firms needed additional funding and failed to obtain it.

When asked if they would go into debt in order to obtain more capital, two-thirds asserted that they would, incorporated business owners being even more prepared to take that risk than the owners of unincorporated firms. The business owners' responses when asked what the additional funds would be used for can be seen in Chart 9.2.1.

Chart 9.2.1 *Uses of Additional Equity in New Firms, 1985¹⁴*



9.3 *Government Programs*

Access to capital is the most pressing financial problem of newly formed small businesses. In response, both federal and provincial governments have developed tax incentives and financing programs to address the equity capital needs of start-ups and young companies.

Small Business Development Corporations

Small Business Development Corporations (S.B.D.C.) were introduced by the government of Ontario in July, 1979. "To encourage equity investment in Ontario-based small businesses, incentives are provided to those who buy shares in an S.B.D.C.(s) for the purpose of directing the invested funds to qualifying businesses."¹⁵

S.B.D.C.s provide certain investors with a 25 percent tax credit (30 percent in Northern and Eastern Ontario) for investments made in businesses operating in the manufacturing, processing, tourism, book publishing or prescribed research and development industries. The October, 1985, provincial budget widened the definition of eligible small businesses to include those companies undertaking computer software development of user-ready programs for sale, lease or license, providing the employees of the small business carry out substantially all of the research, programming and testing. The equity capital of the S.B.D.C. may not be less than \$100,000 (except in Northern and Eastern Ontario, where it may be \$50,000).

A small business is eligible for the S.B.D.C. tax credit when:

- the small business employs fewer than 150 employees;
- 75 percent of the employees' salaries and wages are paid in Ontario;
- the investment is not re-lent, invested in land or re-invested outside of Canada;
- the recipient small business's principals are ordinarily resident in Ontario and the S.B.D.C. operates at "arm's length" of the Canadian controlled small business.

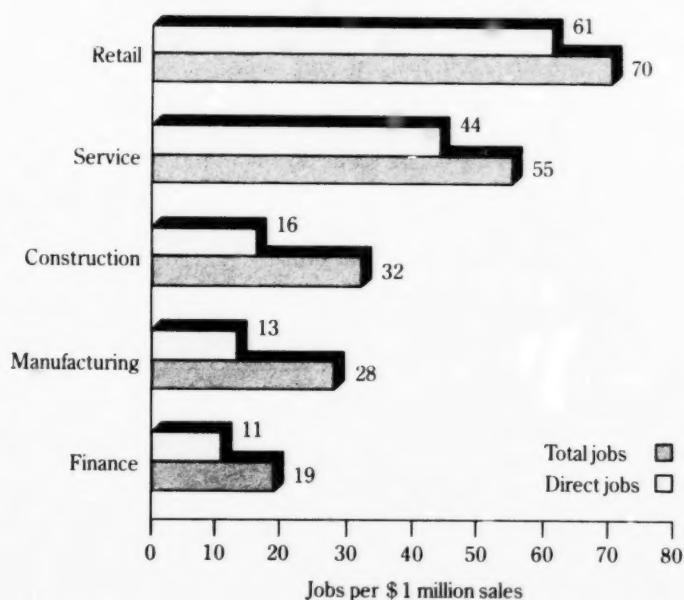
In its report to the Ontario Ministry of Treasury and Economics, Clarkson Gordon concluded that the S.B.D.C. program was "...successfully meeting its objectives of supporting small business in Ontario through the encouragement of new equity investment by the private sector. The program is well received by participants, is lauded by major small business organizations, and the efficient administration by the Ministry of Revenue contributes to its success."¹⁶

Another measure of the program's success is the lead given by Ontario, which has resulted in the establishment of S.B.D.C. programs in several other provincial jurisdictions. Ontario's S.B.D.C. program has been judged as "... the most successful of its kind."¹⁷

The S.B.D.C. program is criticized, however, on two counts. Firstly, many members of the small business community feel that they could benefit from greater access to direct equity investment if the minimum capitalization levels were reduced from \$100,000 to \$50,000 across the board.

Another change promoted by many is the broadening of eligibility to include the service sector. The job creating power of the small service companies has been documented in Section 3.1. The business services sector in Canada grew from 23,000 firms in 1976 to about 42,000 in 1982, and the proportion of new jobs they created was even greater. Service companies as a whole provided 55 new jobs for every million dollars of new sales compared to 70 in retail trade and 28 in manufacturing. This is presented graphically in Chart 9.3.1.

Chart 9.3.1 *Job Creation by Industry, Canada, 1978¹⁸*



As Table 9.3.1 shows, services and trade were the most potent job creating sectors of the economy at 37 percent and 21 percent respectively, followed at some distance by manufacturing and finance (10 percent each) and construction at five percent. It is notable, too, that the smallest companies in the service and trade sectors produced the lion's share of the net new jobs.

Although the S.B.D.C. program has assisted in the placing of investments averaging \$185,000 in goods producing companies, two to three times as many new business formations, expansions and new jobs are created by the service companies compared to the goods producing companies. The job creation potential of the service sector is 2.8 times that of the existing combination of manufacturing, processing, tourism, book publishing or prescribed research and development industries. The job creation potential of S.B.D.C.s in the service sector, therefore, could be substantial if one also bears in mind that, according to Statistics Canada, manufacturers must invest approximately \$75,000 to create one new direct job whereas service companies achieve the same result with only \$22,500. Looking at this issue in terms of fiscal pay-back has already helped to point policy makers into new strategic directions.

According to a recent study of 255 presidents of S.B.D.C.s, individuals who invest in S.B.D.C.s are predominantly business executives or professionals. Also, S.B.D.C. investors were not motivated to invest solely because of the existence of the S.B.D.C. program (87.4 percent of total respondents), but also because they wanted to be involved in the process of management of the firms in which their capital was invested (62.5 percent).

When asked whether the desire for involvement was more or less important than the reduction of risk represented by "leveraging gov-

Table 9.3.1 *Percentage of Net Employment Change by Firm and Size of Industry, Canada, 1974-1982¹⁹*

Selected sectors	0-19 %	20-49 %	50-99 %	100-199 %	200-499 %	500+ %	Total
Manufacturing	7.4	1.7	-1.2	-2.3	-3.1	7.7	10.0
Trade	14.0	1.0	-0.4	-0.7	-0.5	7.9	21.4
Construction	6.6	-9.5	-0.8	-0.9	-0.1	0.6	5.0
Finance	4.1	0.6	0.3	0.1	0.3	4.6	10.0
Services	17.1	4.9	2.7	1.9	1.4	9.4	37.4
Total	54.7	8.5	0.6	-1.8	-1.4	39.4	100.0*

*Total does not add to 100 percent vertically as only selected sectors are shown.

ernment funds under the S.B.D.C. scheme," 40 percent felt it was more important, another 40 percent felt it was equally important and 20 percent felt it was less important. Seventy-six percent of the respondents cited the existence of the S.B.D.C. program as an important factor in their decision to invest.²⁰

Small Business Loans Act

In recent years, loan guarantee programs have gained popularity as financing vehicles for small businesses. In Canada, the largest such program is the Business Improvement Loan Guarantee Program of the Government of Canada, created under the *Small Business Loans Act* (S.B.L.A.). The underlying concept behind this program is to deliver government financial support to the private sector by using private sector facilities (the financial institutions implement the program). Small businesses (those with annual gross revenues of \$2 million or less) are eligible to receive loans of not more than \$100,000 at an interest rate of one percent above prime. Although the recipient receives the funds from the financial institution, the government protects the institution from default by underwriting 85 percent of the loaned amount.

Small businessmen and women can use the loans to finance up to 80 percent of the cost of equipment, including installation and 90 percent of construction costs. Refinancing of existing debts or working capital are not eligible. The financial institutions must pay the government a fee of one percent of the loaned amount at the time the loan is registered. However, they are permitted to pass all or part of the costs of this fee onto the borrower.²¹ Table 9.3.2 classifies S.B.L.A. loans by the type of lender.

The average amount borrowed by each applicant has risen from \$8,909 in 1961 to \$26,766 in 1983, and the number of borrowers has grown from 8,368 to 25,820 over the same period.²² The type of business of the borrower is shown in Table 9.3.3.

Research undertaken for The Canadian Banker's Association by the University of Western Ontario reveals that 40 percent of loans made under the aegis of the *Small Business Loans Act* are made to start-up companies compared to only 19 percent of regular high-risk company bank loans. The study goes on to report that the S.B.L.A. program results in a significant volume of term loans to small business that would not have been made if the program had not existed. The authors concluded that as many as 50 percent of all S.B.L.A. borrowers may have obtained other financing to supplement their S.B.L.A. loans.

Especially encouraging is the fact that many loan recipients were

young firms or firms with new owners, less experienced management or firms unable to offer high levels of collateral support. S.B.L.A. recipients surveyed had reduced their borrowing costs by an average of between 75 and 112 basis points. Finally, the study concluded that the S.B.L.A. program enables small businesses to obtain extended loan payment terms.²³

Table 9.3.2 S.B.L.A. Loans Classified by Type of Lender (\$ millions)²⁴

Type of lender	1982	1983	Total	% of total
Banks	400	624	1,024	90.4
Trust companies	19	16	35	3.1
Credit unions	19	48	67	5.9
Other	2	3	5	0.6

Table 9.3.3 S.B.L.A. Loans Classified by Type of Business (\$ millions)²⁵

Type of business	1982	1983	Total	% of total
Wholesale	15	23	38	3.4
Retail	109	180	289	25.6
Construction	38	63	101	8.9
Manufacturing	44	73	117	10.3
Service	185	276	461	40.8
Transportation	45	70	115	10.2
Communications	4	6	10	0.8
Total	440	691	1,131	100.0

Taxation Policy

In a 1985 study of recently registered businesses in Ontario conducted for the Ministry of Industry, Trade and Technology, respondents were asked if they were aware of the Ontario corporate income tax exemption and, if so, how they had applied the savings. This is shown in Table 9.3.4.

Respondents of the survey were then asked how they would make use of the tax exemption savings. Table 9.3.5 indicates these results.

Table 9.3.4 *The Awareness and Use of Savings from Corporate Tax Exemptions — Recently Registered Business Owners in Ontario*²⁶

	%
Aware of exemption	70.6
Percent using the exemption	38.4
(As a percent of those aware)	54.4
Amount saved in 1984 by those using the exemption:	
Under \$5,000	11.5
Over \$5,000	10.9
Don't know	77.6

Table 9.3.5 *The Application of the Savings Derived from Corporate Tax Exemptions — Recently Registered Business Owners in Ontario*²⁷

	%
Purchased or leased equipment	48
Purchased inventory	37
Hired staff	33
Paid down loans	25
Invested in research and development	25
Taken as income	20
Rented or purchased more space	14

Most of the firms surveyed could not remember the exact amount of money saved by the corporation tax holiday, but the average figure for those that did was \$17,500. The comparison of the ranking between what small business owners would do with an extra \$25,000 compared to what they actually used the corporation tax exemption for provides an interesting contrast, as seen in Table 9.3.6.

Table 9.3.6 *The Actual Use of the Savings Derived from Corporate Tax Exemptions Compared to the Potential Application of \$25,000 of Additional Capital — Recently Registered Business Owners in Ontario (by Rank)*²⁸

Potential	Actual
1. Purchase or lease equipment	1. Purchased or leased equipment
2. Hire staff	2. Purchased inventory
3. Pay down loans	3. Hired staff
4. Rent or buy more space	4. Paid down loans
5. Purchase inventory	5. Invested in research and devlpmt.
6. Take as income	6. Took as income
	7. Rented or bought more space

As can be seen, when business owners were asked on what they would spend an additional \$25,000 of capital, they responded similarly though not exactly to the way they acted when they received additional funds in the form of a tax exemption.

The third ranking use of funds is the hiring of additional staff, and the multiplier effect of tax incentives can be clearly demonstrated in Table 9.3.6. In the incorporated firms, the addition to the establishment was 2.9 full-time employees and half a part-time one. Even if these employees were paid the minimum wage for an average work week, their taxes paid would cover the corporation tax exemption.

Computerized Ontario Investment Network

The Ontario government has recognized the need for an efficient mechanism to help bring business owners and potential investors together. These potential investors include wealthy individuals, particularly those who have made their wealth through their own entrepreneurial endeavors, as well as wealthy professionals. It has been estimated that the supply of informal risk capital far exceeds the institutional risk capital supply. Research has also established that this informal risk capital market operates very inefficiently because effective mechanisms do not exist to make suppliers and seekers of capital aware of each other.

The Computerized Ontario Investment Network (COIN) has been created by the Ontario government and the Ontario Chamber of Commerce to bridge this gap.

COIN will be operated by the Ontario Chamber of Commerce as a non-profit enterprise. COIN will function in the following way:

- business owners and investors apply, or are referred to, the Network database;
- business owners' and investors' needs are compared against a set of criteria to generate "matches";
- all matches are communicated only to the relevant investors who, in turn, can decide whether or not to follow up. If the investor does so, the Network will send him/her a summary of the entrepreneur's business plan.

New Ventures Loan Guarantee Program

The New Ventures program guarantees loans up to \$15,000 by private sector lenders such as banks, trust companies and credit unions to new small businesses. A matching equity contribution by the business owner is required; also, at least one new job, besides the owner's, must be created. Loan recipients must be established in Ontario and begin operations within four weeks of receiving the loan. For the first 12 months, participants will pay interest only at the rate of prime plus one percent.

Chapter Notes

¹Economic Council of Canada based on unpublished data from Statistics Canada.

²Ibid.

³Ibid.

⁴Statistics Canada, Corporation Financial Statistics.

⁵Andrew Szonyi and Greg Leach, "Characteristics and Expectations of Suppliers of 'Informal' Venture Capital in Ontario," paper presented to the Third Annual Conference, International Council for Small Business — Canada, May, 1984.

⁶Ibid.

⁷Russell M. Knight, "An Evaluation of Venture Capital Rejections and their Subsequent Performance," *Journal of Small Business and Entrepreneurship*, fall, 1985, p. 31.

⁸Ibid.

⁹*1985 Banking Survey*, Canadian Federation of Independent Business, Toronto, December 11, 1985.

¹⁰Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

¹¹Ministry of Industry, Trade and Technology, research undertaken at the Companies Branch of the Ministry of Consumer and Commercial Relations.

¹²Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

¹³Ministry of Industry, Trade and Technology, research undertaken at the Companies Branch of the Ministry of Consumer and Commercial Relations.

¹⁴Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

¹⁵*Assistance to Business in Canada*, Federal Business Development Bank, 1984, p. 204.

¹⁶Clarkson Gordon, *An Evaluation of the Small Business Development Corporations Program*, February, 1984, p. i.

¹⁷Ibid. pp. 43-44.

¹⁸Statistics Canada and Ministry of Industry, Trade and Technology, Small Business Branch.

¹⁹DRIE, "Job Creation Process in Canada," undertaken with assistance by David Birch, October, 1984, p. 13.

²⁰Andrew Szonyi and Greg Leach, Op. Cit.

²¹Jim Hatch, Larry Wynant and Mary Jane Grant, "Bank Lending Under the Small Businesses Loans Act," *Canadian Banker*, October, 1985, p. 30.

²²Jim Hatch, Larry Wynant and Mary Jane Grant, *Government Loan Guarantee Programs for Small Business*, University of Western Ontario, July, 1985, p. 22.

²³*Ibid.*, p. XII.

²⁴*Ibid.*, p. 23.

²⁵*Ibid.*

²⁶Ministry of Industry, Trade and Technology, internally commissioned research undertaken by the Creative Research Group.

²⁷*Ibid.*

²⁸*Ibid.*

10

The Effects of Public Policy on the Small Business Community

10.1 *Government Programs and Small Business*

During the mid-eighties, the extraordinary resilience of the small business sector and its job creation power in a turbulent and changing economy caught the attention of policy makers. In February, 1985, the Minister of State for Small Business (itself a new governmental function resulting from a new awareness of these events) redefined the thrust of federal government policy "...to create an environment for the small business sector that is conducive to start-ups, investment and growth and is free of major obstacles." This followed an earlier assertion by the Prime Minister that "Our goal is to unfetter the private sector — especially the small business sector — so as to enhance that entrepreneurial spirit and creative genius that encourages risk, rewards productivity and creates new economic opportunities for Canada."¹

The Province of Ontario is concerned with encouraging an environment that is sympathetic to the formation of new businesses.

The Small Business Branch of The Ministry of Industry, Trade and Technology seeks to effect a direct increase in the magnitude of new job opportunities available in Ontario through improving:

- the climate for small businesses in Ontario;
- the calibre of management skills employed in small business operation; and
- the prospects for survival and growth of small businesses in Ontario.

As part of this mission and in response to the identified needs of new and established small businesses, the Small Business Branch has organized its activities to provide advice and counsel and advocacy services on a province-wide basis.

Advice and Counsel Services

Inadequate or unbalanced management skills are regularly identified² as the major cause of known small business failure in Canada. In an attempt to reduce the number of new small businesses that fail and accelerate the growth of all Ontario small businesses, the Branch provides:

- more than 200 free or low cost seminars across the province on such topics as how to start a small business, marketing, product costing and productivity improvement;
- approximately 150,000 copies of publications per year on a variety of business planning and management topics; and
- direct counselling to individuals.

The 304,000 small businesses in Ontario and the more than 100,000 annual new starts provide a client base of such magnitude that the Branch has turned to other institutions, local governments and community organizations to assist in meeting client demands. These local agents include:

- 13 business faculties on 12 university campuses that provide low cost consulting to small business;
- seven municipalities and community groups in Thunder Bay, London, the Region of Waterloo, Brantford, the City of York, Kanata and Cornwall that are providing various combinations of advisory services, low cost space and common services as part of the Community Small Business Centre program;
- five local women's organizations in Thunder Bay, Sudbury, London, Toronto and Ottawa that are addressing the unique needs of established and potential women small business owners;
- TVOntario, producers of *Frontrunners*, a series on successful Ontario small business with a low cost companion home-learning package; and
- pilot Self-Help Centres in ministry offices in Kitchener and Ottawa, testing the concept of a walk-in centre providing professional help, a quiet place to work, a complete array of business literature and computer services.

Access to these and other services is facilitated by the ministry's Domestic Offices Branch, with 45 field officers in 18 offices across the province, and the Small Business Hotline — a toll-free province-wide telephone service.

The focus of the majority of these services is the potential small business person or new small business. The emphasis is business planning to better prepare the owner-manager to deal with contingencies when they arise. Analysis of the age pattern of known business failures³ indicates a rapid decline in the rate of business failures beyond year four, as they mature and management becomes more experienced.

As partial measures of the increasing importance Ontario small businesses place on planning and management skill development, pilot self-help centres are serving an average of 250 clients a month, the Small Business Hotline is providing callers with information on rules, regulations and available services at an annual rate of 85,000, as shown in Charts 10.1.1 and 10.1.2. More than 16,000 Ontarians have voluntarily registered as advisory service clients since April, 1985.

Chart 10.1.1 *Small Business Hotline — Enquiries, 1986¹*

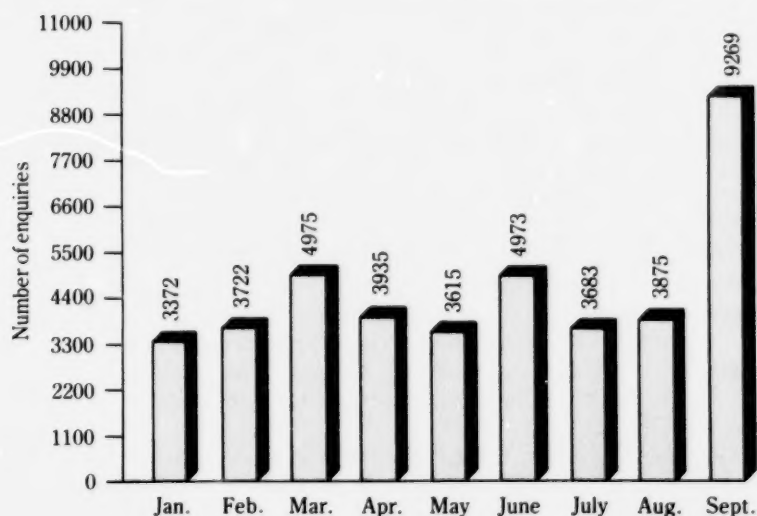
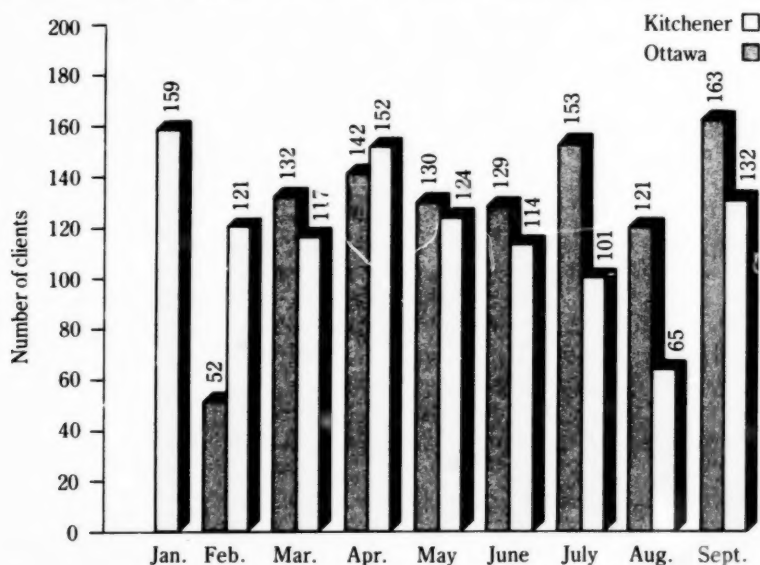


Chart 10.1.2 Self-Help Centres, Enquiries by Month, 1986^s



Small Business Advocacy

In the area of public policy action, it is estimated that the Small Business Advocacy unit of the Branch has identified and advocated on issues that will have a beneficial effect on small business in Ontario worth over \$500 million over the next four years.

Small Business Advocacy staff work on virtually all aspects of legislation and public policy that affect the owners of small firms and their employees. Currently there are projects under way in the fields of taxation, labour relations, business practices, financing, regulation and economic development. Recently, Small Business Advocacy has given special attention to the role of entrepreneurship in the development of Northern Ontario.

In the area of access to financing, Small Business Advocacy has participated in three recent initiatives. In concert with staff of the Ministries of Revenue and Treasury and Economics, the unit advised on broadening the Small Business Development Corporations program to help finance more firms in the service industries. Advocacy intervened with the federal government, leading to new rules permitting invest-

ments via Registered Retirement Savings Plans in Canadian private companies. Advocacy also helped design Ontario's New Ventures program of guaranteed loans for newly started companies.

Advocacy participated in the inter-ministerial working group on pay equity, which produced the green paper published in 1985. Subsequently, Small Business Advocacy studied the employment practices of small firms with a view to advising on pay equity legislation.

Along with the Ministry of Tourism and Recreation, Advocacy participated in a study of small business paperwork and regulation sponsored by the Federal Department of Regional Industrial Expansion. This study examined the problems experienced by small businesses, particularly firms in the tourism field.

Advocacy also advised the government on the question of the sale of beer and wine in independent grocery stores and demonstrated the substantial job creation benefits that would accrue if independent stores received licences to sell beer and wine.

Small Business Advocacy has helped shape Ontario and federal legislation over the past two years. While there are no formal arrangements for early access to legislation, procedures have evolved within the Ministry of Industry, Trade and Technology to alert Advocacy staff to actions that have a bearing on the small business community.

10.2 Deregulation

There are a number of movements towards the deregulation of financial institutions and vehicles in Canada. On July 3 of this year, Bill 87, the *Loan and Trust Corporations Act*, 1985, was withdrawn and a new first reading bill, the *Loan and Trust Corporations Act*, 1986, was introduced. Among other things, the new legislation provides for increased investment latitude for loan and trust companies, specifically participation in commercial lending. Small business owners have reason to be encouraged by this development as it may result in loan and trust companies investing more in small business than they presently do.

The 1985 Ontario Securities Commission report "A Regulatory Framework for Entry Into and Ownership of the Ontario Securities Industry" proposes that non-residents be allowed to own up to 30 percent of a securities firm and that Canadian financial institutions be allowed to own at least that much (presently they are allowed only 10 percent). The proposals should lead to greater access to capital and a more competitive securities environment, both of which will force securities firms to look more towards investment in small enterprises.

Finally, on July 4, 1986, the Pension Commission of Ontario

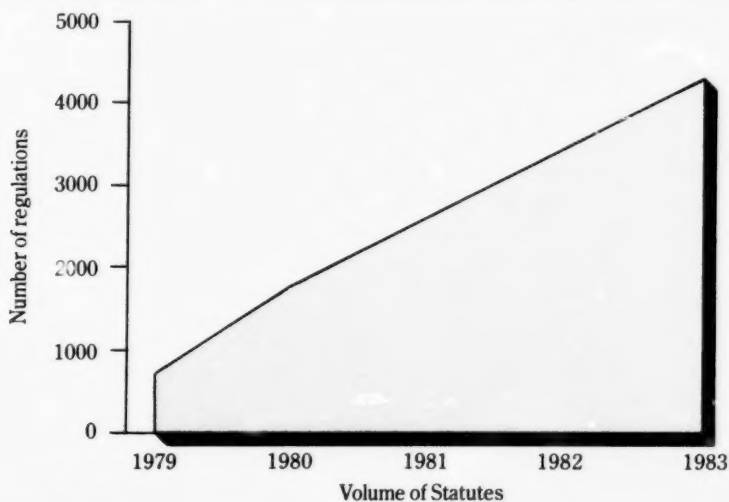
released "Policy Recommendations for the Regulation of Pension Fund Investments," which included as one of its proposals that pension fund managers be given greater freedom and flexibility in making investment decisions. Again, small business owners and entrepreneurs should be encouraged as pension fund managers are likely to now invest in smaller, and perhaps riskier, businesses.

Regulatory Reform

In September, 1984, a Ministerial Task Force on Program Review was established by the federal government headed by the Deputy Prime Minister, the Hon. Eric Neilsen. Members of the task force, which included the Minister of Finance, the President of the Treasury Board and the Minister of Justice, comprised 19 mixed private/public sector study teams. These teams reviewed 989 programs and tabled their findings in December, 1985. The 146 federal regulatory and regulatory-related programs reviewed cost \$2.9 billion in fiscal 1985-86 and involved 35,000 public servants. The Neilsen Task Force estimated the total cost of federal regulation to be at least \$30 billion a year.

Regulation, according to the Neilsen Task Force, is "...the imposition of rules by the state backed by the threat of sanctions with the objective of modifying or controlling private behaviour."⁴ Deregulation

Chart 10.2.1 *New Ontario Government Regulations, Cumulative Growth, 1979-1983⁵*

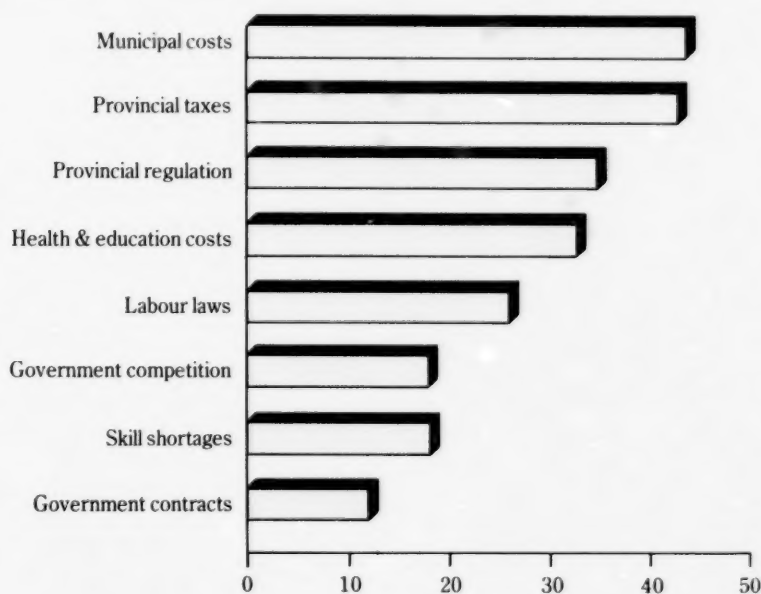


does not mean the total absence of regulation, but rather the reduction of control of such critical factors as prices, conditions of entry and exit and other competitive or market-related issues. As the Neilsen Report points out, "Such sectors [in the United States] as the airline, trucking, financial and communications industries are not truly deregulated at all."⁶

Twenty Ontario ministries have either a supportive or regulatory relationship with small business in the province; 27 federal departments and agencies tax, license, regulate or assist these firms; municipal government agencies and departments add a further level of government interface to the small business sector. Analysis of the Volume of Statutes tells the story in Chart 10.2.1.

A fall, 1984, survey of 500 small businesses recently established in Ontario revealed that 49 percent of those surveyed ranked "government paperwork" as their number two problem (behind "profitability" [60 percent] and ahead of "finding customers" [45 percent]). Chart 10.2.2 highlights these. Paperwork was the number one issue for all

Chart 10.2.2 *What Troubles Ontario Entrepreneurs?*⁷



recently registered small business owners who employed staff, with 58 percent of them citing this as a major concern.⁸

A 1985 study of new business registrants in Ontario showed that, while recently incorporated firms spend 10 hours a week filling out government forms (7.5 hours in unincorporated firms), only 2.3 hours was devoted to this chore by the owners, the balance being undertaken by employees (the same for the owners of unincorporated firms).

A 1980 survey of firms employing 100 people or fewer found that dealing with government paperwork was an even greater burden than government regulation itself. Ontario small business owners believed that government paperwork rather than regulation was the greater burden (80 percent versus 20 percent) compared to Newfoundland (82 percent versus 18 percent), P.E.I. (91 percent versus 14 percent), Nova Scotia (82 percent versus 18 percent), New Brunswick (88 percent versus 12 percent) and Quebec (78 percent versus 18 percent).

In all provinces except Quebec, small business owners believed a greater paperwork burden was imposed upon them by the federal than the provincial government. Ontario's small business owners reckoned that their provincial government accounted for 31 percent of the time that they spent in dealing with all governmentally initiated paperwork (versus 74 percent in Quebec, 37 percent in Saskatchewan, 24 percent in Manitoba, 22 percent in British Columbia, 21 percent in New Brunswick and Newfoundland, 17 percent in Nova Scotia, 15 percent in Alberta and 13 percent in Prince Edward Island).

These studies have been conducted since 1975 to ascertain small business owners' perceptions of their single most important business problem. In that year, "government regulations and paperwork" ranked first relative to other business concerns. A measure of the progress that all levels of government have made in this area may be assumed from the fact that this issue, although remaining in the top five concerns, has been replaced by "inflation," "quality of labour" and "financing" in recent years. Federal employee deductions are seen as the major source of government paperwork in all industry sectors' sizes of firm and geographical location.⁹

A 1981 study of the impact of economic regulation on small business, commissioned by the Economic Council of Canada, debunked the popular myth that "small business is being crushed by regulation." The report pointed out that it was not the paperwork or the regulations that impacted on small business owners so much as the "... regulators who are too often narrow in purpose, who lack understanding of the effects of the regulations/paperwork they create or who have a very limited understanding of business."¹⁰

The same study also found (again, contradicting popular opinion) that, in 95 percent of cases, small businesses complied with economic regulations, initially absorbing the costs of compliance. Only 25 percent pass these costs on to their customers. Between one quarter and three quarters of the costs are passed on by 15 percent of the small businesses while 10 percent of this study group were found to discontinue or avoid the line of business affected.

Both the federal government and small business owners agree that some government regulation of business is both necessary and desirable. The issues change with the times but this common philosophy prevails.

What is needed, however, is frequent reappraisal of the behavior that society seeks to modify and an overhauling of how regulation is instituted. Specifically, research into small business owners' views suggests that the propensity towards paperwork creation must be curbed and government program officers should be trained to be more sensitive to the special requirements of small business owners.

Advocacy, referred to in the previous section, is complementary to deregulation, and is an important method by which the government can ensure sensitivity to the concerns of the small business constituency. Among some of the options available:

1. Reforming the Regulatory Process

Improving the process for developing new regulations by:

- mandatory analysis for proposed regulations;
- publication of regulatory agendas;
- institutionalizing Notice-and-Comment procedures;
- legislative oversight, incorporation of sunset provisions and mandatory review;
- regulatory flexibility, enacting simpler rules for smaller firms;
- exemption of small businesses from coverage of legislation.

2. Selective Review

Eliminating or revising regulations that are outmoded, superfluous, unenforceable or duplicative. A follow-up system can help to ensure that revised regulations remain up to date.

3. Full or Partial Deregulation

Reducing or eliminating government control over a particular sector of industry or segment of economic activity. This can be accomplished in either an instantaneous or a phased manner.

4. Self-Regulation

The conferring of regulatory and disciplinary authority by the government to members of professional, trade or industry associations within a sector of economic activity. Supervisory authorities are usually accountable to the government for the conduct of their regulatory activities.

5. Contracting Out and Privatization

Conceptually similar to self-regulation, the professional, trade or industry association regulates an economic activity while the government supervises and retains an element of control through provisions with the private regulatory body.

6. Reducing Regulatory Costs

In addition to some of the options described above, de-emphasizing compliance standards and placing greater emphasis on fines, liability remedies, taxation and charges can reduce private costs. Incentives can be used to encourage or prompt activities that would otherwise have to be induced by compliance standards.

7. Re-orientation

Changing the shape or shifting the intent of regulations. This can be achieved, for example, by emphasizing preventative rather than remedial measures.

8. Inter-Governmental Regulations

Eliminating or limiting areas of overlap in jurisdiction and enforcement, and contributing to regulatory reform by alleviating duplication, inconsistencies and conflict.

Obscured by the many other findings, pronouncements and recommendations to be found in the Ministerial Task Force on Program Review are two statements that may be seen as harbingers of an important attitudinal change for small business and the entrepreneurs who start, manage and build them in Canada. The report states, quite unequivocally, "The government recognizes the vital role of an efficient marketplace and a dynamic entrepreneurial spirit in generating the ongoing economic growth needed to improve the standard of living for Canadians and it recognizes that regulation should not impede those values without the most persuasive justification."¹¹

Chapter Notes

¹*Consultation Paper on Small Business*, Department of Regional Industrial Expansion, February, 1985.

²Dun and Bradstreet, Bankruptcy Report, Canada, 1984.

³Ibid.

⁴"Background to the Regulatory Reform Strategy," press release, Office of the Deputy Prime Minister, February 13, 1986.

⁵Small Business Branch Plan 1985-1986, Ministry of Industry, Trade and Technology.

⁶Background to Regulatory Reform Strategy, Op. Cit.

⁷Ministry of Industry, Trade and Technology, Small Business Branch, research commissioned from the Creative Research Group.

⁸Ministry of Industry, Trade and Technology, Small Business Branch, internal research.

⁹Rein and Mari A. Peterson, Working Paper Number 24, "The Impact of Economic Regulation and Paperwork: Is Small Business Being Crushed?" Economic Council of Canada, August, 1981.

¹⁰Ibid.

¹¹Background to the Regulatory Reform Strategy, Op. Cit.